(29,660)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1923

No. 352

THE PEOPLE OF THE STATE OF NEW YORK, PETITIONER,

vs.

LOUIS JERSAWIT, AS TRUSTEE IN BANKRUPTCY OF AJAX DRESS COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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[fols. 1-3] **UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK**

In the Matter of AJAX DRESS CO., INC., Bankrupt

CLAIM OF STATE OF NEW YORK FOR FRANCHISE TAX, FILED WITH REFEREE IN BANKRUPTCY IN COVER, CLAIMING PRIORITY OF PAYMENT AND LIEN

Additional Statement

March 24, 1922.

Ajax Dress Co. Inc., 15 East 26th St., Moses & Singer, Attys. for Trustee, 55 Liberty Street, New York City, in Account with the State of New York, Dr.

State Tax Department, Albany, N. Y., Finance Bureau

Additional statement of your account is hereby rendered for taxes due on or before January 1, 1921, payable without penalty at that time, or within 30 days from November 4, 1920, the date under which these taxes (prior lien) were originally noticed to you pursuant to Article 9-A of the Tax Law, as amended.

Money order, draft or certified check made payable to State Tax Commission, Albany, N. Y., should be forwarded to this bureau, with this form.

[fol. 4] State Franchise Tax on Business Corporations under Article 9-A of the Tax Law as Amended

Postage stamps and uncertified checks not accepted.

For Period Ending October 31, 1921

Tax based on income 4½%	$448 34
Tax based on cap. stock at 1m	.....
Minimum tax	.....
Penal interest, etc.	87 03
Total	$535 37

Received Payment,

—— ——, Assistant Deputy Commissioner.

To Louis Jersawit, 2 Rector Street, N. Y. City:

Please *tax* notice that annexed hereto in a statement of franchise taxes due the State of New York and for which the State of New York claims a preference over and above all the debts of the bank-

rupt and claims submitted to you and demands that said amount be forthwith paid by you in full out of any moneys now in or which may hereafter come into your possession.

Dated, March 30, 1922.

Charles D. Newton, Attorney-General of the State of New York, Office and P. O. Address Capitol, Albany, N. Y.

[fol. 5] HEARING BEFORE REFEREE ON CLAIM OF STATE OF NEW YORK IN RE AJAX DRESS CO., No. 28834

Before Hon. John J. Townsend, Referee

Final Meeting of Creditors, Held Pursuant to Notices Mailed April 1, 1922

New York, April 12, 1922, at 11.45 a. m.

Present: Moses & Singer, by Mr. Rubenstein, for the trustee; Charles P. Robinson, Deputy Attorney-General, for State of New York; Samuel Gorschen, secretary of the bankrupt.

The Referee: I have before me the Trustee's final report, filed March 11, 1922, showing a balance of $3,400.39.

I have before me the petition and application of Moses & Singer, for an allowance as attorneys for the Trustee.

I have also before me the application of the appraisers for an allowance, filed April 8, 1922.

I want to know are there any other applications? I call attention to the claim of the State of New York, filed April 3d at $535.37, for a franchise tax for the period ending October 31, 1921. In this case the petition was filed against the bankrupt corporation on December 22, 1920. Are there any other applications? Otherwise, I will proceed to consider each application separately.

Are there any objections to the Trustee's report as filed? I hear no response. Do you move to sell the outstandings mentioned in [fol. 6] Schedule A annexed to the Trustee's report?

Mr. Rubenstein: I do.

The Referee: I offer for sale the right, title and interest of the bankrupt estate in those outstandings without any representation of any kind. I will offer all three items together, unless some bidder wants me to offer one item at a time. If not, I will offer all three. What am I bid for them?

Mr. Gross: Five dollars.

Mr. Gorschen: Fifteen dollars.

The Referee: Are there any higher bids? First call, second call, third and last call, sold to Mr. Gorschen at $15, for Samuel Trokie, 339 Vermont Street, Brooklyn.

The Referee: I have the application of Messrs. Moses & Singer,

attorneys for the Trustee. Is there anything to be said outside of the filed application?

Mr. Rubenstein: No, sir, except that we feel that the services rendered justify double the Trustee's commissions.

The Referee: Do you ask for a certificate?

Mr. Rubenstein: No, sir. We leave it to your honor, and make the suggestion that we be allowed double the Trustee's commissions.

The Referee: Is there anything to be said on the application of the appraisers?

[fol. 7] Mr. Rubenstein: No, sir, nothing in addition to their petition.

The Referee: I will hear the Trustee's objections to the claim of the State of New York.

Mr. Rubenstein: The tax for which claim has been filed by the State of New York is based upon the franchise, and that franchise was only exercised by the bankrupt company for a period from October to December of 1920, or about one and two-thirds months. I make objection to the claim on the ground that the claim is subject to apportionment by the court, and should be apportioned by reason of the fact that the corporation never exercised its charter beyond that one and two-thirds months. I also object to the claim on the ground it provides for a penalty as against the estate, and that the court has no jurisdiction to enforce a penalty against the estate where the estate was in process of administration.

The Referee: You mean the penalty is not to be allowed under Section 57-j?

Mr. Rubenstein: Yes.

Mr. Robinson: I would like to have three or four days in regard to the penalty part, within which to advise the Tax—the State Tax Department. I don't think they are entitled to the penalty.

The Referee: I will rule upon that now. I will not keep this open. I will make a separate order disallowing the penalty.

Mr. Robinson: And in regard to the other issues.

[fol. 8] The Referee: I shall sustain the objection to the penalty, and will enter a separate order, if desired, to that effect.

Mr. Robinson: I don't ask you to do that.

The Referee: It is only to reserve your rights. The period is said to be twelve months ending October 31, 1921. That is the period of exercise—the tax is payable as stated in advance. It is payable in November of 1920.

Mr. Robinson: If the court please, as you undoubtedly know, every corporation in July of every year files a return with the State Tax Department of its income as shown on its return to the United States treasurer for the preceding calendar year. The State Tax Department then audits and states that tax of four and a half per cent on that income and sends a bill for it to the corporation, and the bill to this corporation, it appears from the statement was sent on November 4, 1920. The tax is audited and stated for the privilege of exercising the franchise in case of a domestic corporation for the year commencing the following November 1st—in this particular

instance, the company received notice on November 4, 1920, of the audit and statement of the tax in the sum of $448.34.

The Referee: The exercised period was for the year ending October 31, 1921, beginning November 1, 1920?

Mr. Robinson: Section 219-C of the Tax Law provides that the franchise tax due from any corporation constitutes a lien upon all [fol. 9] real and personal property of that corporation from the time when the tax was payable, until it is paid in full. At the beginning of that Section 219-C it is provided that the tax is payable on or before January 1st of every year, and within thirty days after the notice of the audit of the tax was sent to the corporation. In this particular case, there can be no question, but what this tax constituted a lien or became a lien against all the real and personal property of this corporation on December 4, 1920, and there is very good ground for considering the tax a lien on November 1, 1920. The tax is payable in advance, it being a lien prior to the date of the adjudication of the bankrupt. There is, I believe, no authority for the apportionment of this tax, for the time during which the company actually exercised its franchise. Furthermore, the bankruptcy proceeding does not dissolve a corporation—a domestic corporation pays a tax for the privilege of exercising its franchise, and the company has had that privilege, notwithstanding the bankruptcy proceedings, during all of the year from November 1, 1920, to October 31, 1921.

The Supreme Court of the United States in the case of Marshall against the People, with which the Court is familiar held that the interpretation placed upon a lien of the State for its tax under said statute was conclusive upon it. The Court of Appeals in this State in the case of the New York Terminal Company against Gross, 204 New York, 512, held that the lien under the Tax Statute was superior to all other liens against the corporation, even though the other liens were prior in point of time, holding in that particular [fol. 10] case, that the lien of a franchise tax was superior to the lien of a mortgage which antedated the tax lien, and that it was collectable against a Receiver appointed in a mortgage foreclosure action. The United States Circuit Court of Appeals, and the Supreme Court of the United States has repeatedly held that franchise taxes are collectable against a Receiver. I think we are entitled to the priority of payment for the principal of the tax.

The Referee: I will dispose of this matter now. The State of New York is here asserting a franchise tax assessed under Section 209 of the Tax Law for the period beginning November 1, 1920, and October 31, 1921.

Such tax has been assessed under a report made by the bankrupt corporation under Section 211 of the Tax Law, based on the income of the corporation at that time, on or about July of 1919 or prior thereto.

The tax normally if the corporation had been a going concern was payable in advance in November of 1920, under Section 219 of the Tax Law, and in particular subdivision 219-C of that Section

219, declares the tax to be a lien from the time when it is payable until it is paid in full.

In this proceeding, the petition in bankruptcy was filed against the corporation on December 27, 1920, and the Referee is of the opinion that at the utmost the corporation exercised its franchise during — ending October 31, 1921, for an outside period of two months, beginning November 1, 1920.

The Referee is of the opinion that the bankruptcy Court is clothed with jurisdiction under Section 64-A of the Bankruptcy Statute on [fol. 11] the objections of the Trustee to determine the amount or legality of any tax asserted.

Accordingly, the Referee will allow the asserted tax at two-twelfths of the amount, and exclude any penal interest.

If desired by the Attorney-General, the Referee will make a separate order containing this feature of the case, so that it may be reviewed, pending the making of the final order in the bankruptcy proceeding.

Mr. Robinson: I except to the ruling of the Referee, and ask that a separate order be entered.

The Referee: Prepare an order on notice to the Attorney-General.

Hearing closed.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

MEMORANDUM OF REFEREE DENYING APPORTIONMENT OF TAX

Memorandum of Referee

On December 22, 1920, a petition in bankruptcy was filed against [fol. 12] the Ajax Dress Co., Inc., which I assume was a domestic manufacturing or mercantile corporation.

On April 3, 1921, the State of New York filed a proof of claim for a State Franchise Tax based on income at 4½% ($448.34) and "penal interest, etc." at $87.03, making a total of $535.37.

The proof of claim states that the tax is "for the period ending October 31, 1921," which period, it is conceded, if the year beginning November, 1920: the tax being payable on or before January 1, 1921.

It is to be noted that the petition in bankruptcy was filed against the corporation on December 22, 1920.

The contention of the Trustee is that this tax should be apportioned and allowed only at roughly speaking, two-twelfths, viz.: for the month of November, 1920, and December, 1920, and that all interest, whether penal or otherwise, should be expunged.

The tax is assessed pursuant to the provisions of Section 209 of the Tax Law. This section as it now reads, provides that "for the privilege of exercising its franchises in this State in a corporate or organized capacity, every domestic mercantile corporation, and for

the privilege of doing business in this State, every foreign manufacturing and every foreign mercantile corporation * * * shall annually pay in advance for the year beginning November first next preceding, an annual franchise tax * * *

This Section 209, added to the Tax Law in 1917, follows the text of Section 182 of the Tax Law as the latter now reads since the [fol. 13] amendment of Section 182 by Chapter 333 of the Laws of 1916, which amendment was subsequent in date to the decisions of the New York Court of Appeals, mentioned below, interpreting Section 182 when the words "doing business or" preceded the words "exercising its corporate franchises" in that section.

Compare: People ex rel. L. & N. Y. R. R. Co. v. Sohmer, 217 N. Y. p. 443, and N. Y. Terminal Co. v. Gaus, 204 N. Y. 512.

In other words, since 1916 the Legislature seems to require the tax for the privilege of exercising corporate franchises, irrespective of whether or not the corporate franchises were exercised; establishing a rule in derogation of the former rule as interpreted by the New York Court of Appeals in 217 N. Y. 443.

I repeat, Section 209 in substance follows the language of Section 182 as the latter reads to-day.

The principal question before me is whether or not the franchise tax assessed under Section 209 is apportionable, in view of the fact that the business of the corporation ceased on December 22, 1920, when a petition in bankruptcy was filed against it, viz.: some two months subsequent to November 1, 1920.

No question as to the amount of the tax, viz.: whether the tax has been computed upon the basis mentioned in Section 209, is raised to be heard and determined by me under Section 64-a of the Bankruptcy Act: In re Anderson, 48 A. B. R. 350.

As supporting a right of apportionment, the Trustee cites the de- [fol. 14] cision of New York Court of Appeals in the People ex rel. Mutual Trust Co. v. Miller, 177 N. Y. 51, and more particularly at the top of page 55.

In this decision the Court of Appeals apportioned a tax stating that if the Company ceases to do business six days after the year begins, the tax for doing business by the year requires apportionment.

This case was decided in December, 1903, under the section of the Tax Law cited at page 53 of the report.

The statute before the Court of Appeals in 177 N. Y. 51 now appears, unchanged, in Section 188 of the present Tax Law.

It will be noted that this Section 188, relating to trust companies, and its fellow Section 187, relating to insurance companies, provides that the franchise tax shall be paid annually for the privilege of exercising the corporate franchise of the corporation or carrying on its business in a corporate or organized capacity; differing thus from Section 182 as amended in 1916 and from Section 209 which follows Section 182 as amended. Neither does the feature of payment in advance appear.

The foregoing analysis shows that the New York Court of Appeals has not passed upon the apportionability of a franchise tax im-

posed either under Section 182 or under Section 209, commented upon above, where the tax is payable in advance.

In my opinion, the filing of the petition in bankruptcy and the closing of the doors of the factory of the Ajax Dress Co. in law did [fol. 15] not suspend or impair in any way the corporate franchise granted to the corporation by the State of New York, or take away from the corporation the privilege granted by the State of exercising its corporate franchises in the State if it could secure the necessary funds.

In my opinion, the tax imposed under either Section 209 or Section 182, as amended, is a payment for a privilege whether exercised or not, and is due annually from the corporation until its franchises are withdrawn by the legal dissolution of the corporation, provided always that such tax or payment has been computed or ascertained in the manner required by Section 209 and Section 182, as amended.

I have before stated that the computation of the tax in the case before me is not assailed.

These views lead me to deny the application to apportion the tax which is payable annually in advance on "or before" January first of each year, which in the present case means January 1, 1921, or before that day.

In the absence of other reason for the apportionment of the tax, the fact that the tax is payable in advance on or before January 1, 1921, for the year beginning November 1, 1920, affords, in my opinion, no reason for apportionment. As is well known, rent due and payable in advance (for the unenjoyed privilege of occupation of premises) is never apportioned in bankruptcy.

The same seems to be true of taxes; In re Sherwoods, Inc., C. C. A. 2d Circuit, infra page 5.

There remains to be considered the rights of the State of New York arising under Section 219-c of the Tax Law when read in con- [fol. 16] nection with Sections 64-a and 57-j of the Bankruptcy Act.

It will be seen that Section 64-a is silent as to interest.

In re Fisher & Co., 17 A. B. R. 404, 413; 148 Fed. Rep. 907.

Normally, debts owing to an individual, carry interest only to the date when the petition in bankruptcy was filed.

Sexton v. Dreyfus, 219 U. S. 339; 25 A. B. R. 363, 4, 5.

Sexton v. Dreyfus is not, however, concerned with Section 57-j of the Bankruptcy Act.

Section 57-j reads as follows:

"Debts owing to the United States, a State, a county, a district, or a municipality as a penalty of forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

Taxes are regarded as a debt by the Bankruptcy Act: In re Sherwoods, Inc., 31 A. B. R. 769, 772, foot p. 773; 210 Fed. Rep. 754.

Section 219-c of the Tax Law provides that the corporation shall pay "in addition to the amount of such tax, ten per centum of such amount, plus one per centum for each month the tax remains unpaid."

[fol. 17] The ten per centum is clearly a "penalty" and should be disallowed; nor do I understand the State to contend otherwise.

The State, however, claims the one per centum for each month the tax remains unpaid and claims it as "interest" and not as "penalty" within the provisions of Section 57-j of the Bankruptcy Act.

Were the question open, I would be of the opinion that the high rate of interest is a penalty, rather than interest, and that the purpose of Section 219-c is by punitive provisions to compel prompt payment of the tax.

Notwithstanding In re Kallak, 17 A. B. R. 415; 147 Fed. Rep. 276, or In re G. L. Schuyler & Co., 21 A. B. R. 428, In re Scheidt & Bros., 23 A. B. R. 778, 177 Fed. Rep. 599, or Ramirez-Quinones, 39 A. B. R. 320, 323, I should follow In re Ashland Emery & Corundom Co., 36 A. B. R. 194; 229 Fed. Rep. 829, which allows interest to date of payment, but only at the usual rate of six per centum, were it not for the decision of the Circuit Court of Appeals, 4th Circuit, in U. S. v. Guest, 143 Fed. Rep. 456, which I read as holding a similar statutory provision as prescribing interest and not imposing a penalty.

I cannot see the pertinency to the present controversy of Marshall v. The People, 254 U. S. 380, 383, 384.

These views entitle the State of New York to an order denying the motion of the Trustee.

J. J. Townsend, Referee in Bankruptcy. New York, October 3, 1922.

[fol. 18] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

ORDER OF REFEREE ALLOWING TAX WITH INTEREST AT ONE PER CENT A MONTH AND GRANTING PRIORITY

A final meeting of the creditors of the above named bankrupt having, pursuant to notice, been duly held before me at my office No. 299 Broadway, Borough of Manhattan, City of New York, on the 12th day of April, 1922, at 11:45 a. m. at which time and place objections were made by the trustee to the claim of the State of New York filed herein on the 3d day of April, 1922, in the sum of Five hundred and Thirty-five and 37/100 ($535.37) Dollars for a franchise tax for the period ending October 31, 1921, against the above named bankrupt corporation and the State of New York having duly appeared upon said hearing by the Attorney-General of the State of New York, by Charles P. Robinson, Deputy Attorney-General, of

counsel, the trustee having been represented by Messrs. Moses & Singer, Abraham H. Rubenstein, of counsel, and the objection to said claim having been duly stated by the trustee's counsel upon the record taken at said hearing, and after having heard the Attorney-General in support of said claim and the trustee's counsel in support of the objections to said claim, and due deliberation having been given to the said claim of the State of New York and the objections interposed thereto by the trustee herein, and upon the claim filed by the State of New York herein on the 3d day of April, 1922, [fol. 19] for Five hundred and thirty-five and 37/100 ($535.37) Dollars and the objections thereto, and upon the minutes of the hearing had before me on the 12th day of April, 1922, at 11:45 a. m., it is

Upon motion of Charles D. Newton, Attorney-General of the State of New York,

Ordered, that the claim of the State of New York, filed herein on the 3d day of April, 1922, for a franchise tax for the period ending October 31, 1921, be and the same hereby is allowed in the sum of Four hundred forty-eight and 34/100 ($448.34) Dollars for the principal of said tax and interest upon said principal at the rate of one per cent a month from January 1st, 1921, to the date of the payment of said tax, in addition to the said principal sum, and that said claim be allowed as one entitled to priority of payment.

J. J. Townsend, Referee in Bankruptcy. Dated New York City, N. Y., November 2, 1922.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

PETITION OF TRUSTEE TO REVIEW ORDER OF REFEREE

To the Honorable John J. Townsend, referee in Bankruptcy:

The petition of Louis Jersawit, respectfully shows to this Court and alleges:

I. That he is the Trustee in Bankruptcy of the Ajax Dress Company, Inc., the above named bankrupt, and that as such he has duly qualified.

[fol. 20] II. That in the course of the proceedings in the above entitled matter, on the 2d day of November, 1922, an order, a copy of which is hereto annexed, was made and filed in the office of Honorable John J. Townsend, Referee in Bankruptcy.

III. That such order was and is erroneous in that (a) it allows the claim of the State of New York filed herein on the 3d day of April, 1922, for a franchise tax for the period ending October 31,

1921, in the sum of Four Hundred Forty-eight Dollars and Thirty-four cents ($448.34) for the principal of said tax, and interest upon said principal at the rate of One per cent (1%) per month from January 1, 1921, to the date of the payment of said tax, in addition to the said principal sum; (b) it fails to apportion the tax claimed by the State of New York as a franchise tax, which is assessed for a period commencing November 1, 1920, for one (1) year in advance, although the petition in bankruptcy was filed on the 22d day of December, 1920, and said franchise tax so assessed had only become due at the time of the bankruptcy petition to the extent of two-twelfths (2/12) of a year or one-sixth (1/6) of the amount of the tax; and (c) it allows interest on the amount of the assessment at the penal sum or rate of one per cent (1%) per month in violation of Section 57-J of the National Bankruptcy Act.

Wherefore, your petitioner feeling aggrieved because of said order, prays that the same may be reviewed as provided in the Bankruptcy Act of 1898 and General Order XXVII.

Dated, New York, November 3, 1922.

Louis Jersawit, Trustee, Petitioner.

[fols. 21 & 22] Affidavit of Louis Jersawit to above paper omitted in printing.

Order of Referee Mentioned in Petition for Review—Omitted; printed side page 18 Ante

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[fol. 23] United States District Court, Southern District of New York

[Title omitted]

Referee's Certificate on Petition to Review

To the honorable judges of the District Court of the United States for the Southern District of New York:

I, John J. Townsend, Referee in Bankruptcy, do hereby certify: That in the course of the proceedings had before me herein, the following question arose pertinent to the proceedings:

Under date April 3, 1921, the State of New York filed a proof of claim for a franchise tax based on income at 4½% $448.34 and "penal interest, etc." at $87.03, making a total of $535.37.
[fol. 24] The proof of claim states that the tax is "for the period ending October 3, 1921," which period, it is conceded, is the year beginning November, 1920: the tax being payable on or before January 1, 1921.

The petition in bankruptcy in this case was filed against the corporation on December 22, 1920.

The Trustee contends that this tax should be apportioned and allowed only at, roughly speaking, two-twelfths, viz.: for the month of November, 1920 and December, 1920, and that all interest, whether penal or otherwise, should be expunged.

After consideration, I decided that the State of New York was entitled to an order denying the motion of the Trustee and allowing the claim of the State of New York at $448.34 with interest at the rate of 1% per month from January 1, 1921 to the date of payment, and that such claim be allowed as one entitled to priority of payment; and on November 2, 1922 I filed an order to that effect.

On November 3, 1922, the Trustee filed with me his petition for review, of such order, which was granted.

The question presented on this review is whether the Referee was correct:

(1) In allowing the claim of the State of New York as filed, with interest at the rate of 1%; and

(2) Denying the motion of the Trustee to apportion the said tax.

The question presented, a summary of the evidence relating thereto, and the findings and order of the Referee thereon will be [fol. 25] found in the Referee's Memorandum dated October 3, 1922.

I hand up herewith for the information of the Judges the following papers:

(1) Proof of claim State of New York, filed April 3, 1921.

(2) Order of Referee allowing claim only at $74.72 (this order was subsequently vacated and hearing on the claim reconsidered by the Referee).

(3) Memorandum of Referee, dated October 3, 1922.

(4) Order allowing claim of State of New York at $448.34 with interest at 1% per month.

(5) Petition for review of Trustee, filed November 3, 1922.

New York, November 23, 1922.

J. J. Townsend, Referee in Bankruptcy.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

NOTICE OF HEARING OF PETITION TO REVIEW

SIR: Please take notice that the certificate of John J. Townsend, Referee in Bankruptcy, dated the 23d of November, 1922, on re- [fol. 26] view of Referee's order allowing the claim of the State of

New York at Four Hundred Forty-eight and 34/100 Dollars ($448.34) with interest at the rate of 1% per month from January 1, 1921, to the date of payment, has been duly filed in the office of the Clerk of the United States District Court for the Southern District of New York, and you will further

Please take notice that we shall move this Court at a stated term thereof to be held at the court house thereof, in the Post Office Building in the Borough of Manhattan, City of New York, on the 29th day of November, 1922, at the opening of Court on that day or as soon thereafter as counsel can be heard, for a hearing upon the petition of the Trustee herein for the review of the aforesaid order, said petition being dated the 3rd of November, 1922, and for an order of this Court reversing the order of the Referee herein, and granting the motion of the Trustee herein to apportion the franchise tax for which claim has been filed by the State of New York herein, and for such other and further relief as to this Court may seem just and proper.

Dated, New York, November 27, 1922.

Yours, etc., Moses & Singer, Attorneys for Trustee, Office and P. O. Address 55 Liberty Street, New York City. To Hon. Charles D. Newton, Attorney-General of the State of New York, 51 Chambers Street, New York City.

[fol. 27] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

OPINION OF DISTRICT COURT ON HEARING OF PETITION TO REVIEW

Moses & Singer, Solicitors for Trustee.

Charles D. Newton, Attorney-General for the State of New York, Charles P. Robinson, Assistant.

AUGUSTUS N. HAND, District Judge:

This is a proceeding to revise an order of the referee allowing the claim of the State of New York for franchise taxes for $488.34, and interest thereon at the rate of one per cent. per month from January 1, 1921. Section 209 of the Tax Law of the State of New York (as amended by the Laws of 1919) is as follows:

"Franchise tax on corporations based on net income. For the privilege of exercising its franchise in this state in a corporate or organized capacity, every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section, shall annually pay in [fol. 28] advance for the year beginning November 1st next preceding an annual franchise tax, to be computed * * *."

In the case of People ex rel. Mutual Trust Company v. Miller, 177 N. Y. 55, the statute affecting trust companies was under consideration which provided that

"Every trust company incorporated, organized or formed under, by or pursuant to a law of this state, * * * shall pay to the state annually for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity, an annual tax which shall be equal to one per centum on the amount of its capital stock, surplus, and undivided profits. * * *."

The trust company in that case was organized on the sixth day of June, and began to do business on the twenty-fourth. Its capital was three hundred thousand dollars; its surplus paid in with the capital was sixty thousand dollars. The Court of Appeals held that the tax was upon

" * * * the privilege of exercising, not of possessing, a corporate franchise. This privilege was used by the relator for only six days during the fiscal year in question. It could not exercise its franchise for the entire year, because the state did not bring it into existence until the year had nearly expired. The consideration for the tax is the privilege of carrying on business, yet the relator, according to the requirement of the comptroller, was com- [fol. 29] pelled to pay for a privilege that it did not have and could not exercise during the greater part of the period for which the tax was laid. It used the privilege for only six days, but it is taxed for using it 365 days, during 359 of which it did no business and enjoyed no privilege. An annual tax is a tax reckoned by the year the same as annual rent or annual interest. An 'annual' tax imposed 'annually,' means a tax that is imposed once a year, computed by the year. If a trust company does not commence business until six days before the fiscal year ends, or if it ceases to do business six days after the year begins, the tax for doing business by the year requires apportionment. While the legislature did not so provide in express terms, it is a fair and reasonable implication from the words used that such was its intention."

It is to be noted that while apportionment was ordered by the foregoing decision that the tax was not under the terms of the particular statute there considered payable in advance, but in the case of People ex rel. L. & N. Y. R. R. Co. v. Sohmer, 217 N. Y. 443, Section 182 of the New York Tax Law was considered by the Court of Appeals which at that time provided:

"For the privilege of doing business or exercising its corporate franchise in this state every corporation * * * doing business in this state, shall pay to the State Treasurer annually, in advance, [fol. 30] an annual tax to be computed upon the basis of the amount of its capital stock, employed during the preceding year within this state upon each dollar of such amount."

Notwithstanding the fact that the tax was payable in advance, the court held that a domestic railroad corporation which had leased its railroad to a foreign railroad company but had received no rent and transacted no business except to keep alive its corporate existence by the election of its officers was not liable for a franchise tax for transacting business.

The referee in the present case laid special stress upon the change in the form of the statute in that Section 209, as amended, imposed a tax "for the privilege of exercising its franchise in this state in a corporate or organized capacity." I cannot see any substantial difference between this clause and the one considered in People ex rel. Mutual Trust Company v. Miller, supra, where it read "for the privilege of exercising its corporate franchise, or carrying on its business in such corporate or organized capacity."

As a matter of first impression the question would be very doubtful, and that it was doubtful in the minds of some of the Judges of the Court of Appeals appears from the dissenting opinion of Judge Bartlett in the case of People ex rel, Mutual Trust Company v. Miller, and of Seabury and Pound, JJ., in the case of People ex rel. L. & N. Y. R. R. Co. v. Sohmer, supra. The decisions of the highest court of the state construing the New York Statute are, of [fol. 31] course, binding and seem to me harmonious as to the correct interpretation of the statute. But irrespective of the meaning of the statute, the referee held:

"the filing of the petition in bankruptcy and the closing of the doors of the factory of the Ajax Dress Company in law did not suspend or impair in any way the corporate franchise granted to the corporation by the State of New York or take away from the corporation the privilege granted by the state of exercising its corporate franchise in the state if it could secure the necessary funds."

If I am correct in my understanding of the decisions of the New York Court of Appeals they have rested upon whether the corporate franchises were actually exercised. Judge Vann said in People ex rel. Mutual Trust Company v. Miller, supra (at p. 54):

"The tax under consideration is not imposed upon property, but upon a privilege. It is not imposed upon the privilege of becoming a corporation, for that would be an organization tax, payable but once for the entire period of corporate existence. It is imposed 'for the privilege of exercising' the corporate franchise, and is measured by the value of the investment made and used in carrying on the corporate business."

In the case of McCoach v. Minehill & Schuykill Haven R. R. Co., 228 U. S. 295, a corporation after operating its railroad for [fol. 32] many years leased it. The court said:

"We cannot, however, agree with the contention made in behalf of the Government that because the Minehill Company retains its fra-chise of corporate existence, maintains its organization, and

holds itself ready to exercise its franchise of eminent domain, or other reserved powers, if and when required by the lessee, and ready to resume possession of the property at the expiration of the lease, it is therefore to be treated as doing business, in respect of the railroad, within the meaning of the Corporation Tax Law."

See also Flint v. Stone Tracy Co., 220 U. S. 145, and 150.

The idea that the Ajax Dress Company was exercising its franchise in any practical sense when it was in bankruptcy would seem to be fanciful. An actual exercise and not the mere right without the power to exercise seem to furnish the test laid down by the New York Court of Appeals. The Company was engaged in business during but a portion of the taxable year preceding the filing of the petition under the doctrine laid down in People ex rel. Mutual Trust Company v. Miller, supra, and People ex rel. L. & N. Y. R. R. Co. v. Sohmer, supra. The intervention of the petition in bankruptcy, followed by the adjudication, made the conduct of the business by that corporation impossible.

[fol. 33] For the foregoing reasons the tax in this case should be apportioned.

In regard to interest it should be allowed unless it is at a penal rate. Anything which amounts to a penalty must be disallowed under Sec. 57-j of the Bankruptcy Act. As I have already held in the Matter of J. Menist Co., Inc., Bankrupt, in dealing with the Federal Income Tax Act (in an opinion filed December 5, 1922) the rate of one per cent. per month (here imposed by Sec. 219-o of the Franchise Tax Law) is essentially a penalty. In the case of J. Menist Co., Inc., supra, I followed the opinion of Judge Morton in the case of In re Ashland, Emery & Corundum Co., 238 Fed. 839, and allowed interest at six per cent. per annum, which is particularly justified here because it is the statutory rate which the laws of the State of New York impose upon individuals in the absence of some special agreement for less. Taxes are not like ordinary debts where interest is computed to the date of filing the petition but whatever interest is allowed runs to the date of payment. In re Kallak, 147 Fed. 276. I presume it will not be disputed by the State of New York that the full sum of ten per cent. imposed in the discretion of the State Tax Commission upon delinquent taxpayers is clearly a penalty.

Let the order be settled, upon notice, apportioning the franchise taxes and allowing interest at six per cent. on the tax as apportioned to the date of payment.

A. N. H., D. J. December 7, 1922.

[fol. 34] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER OF DISTRICT COURT REVERSING REFEREE'S ORDER

A final meeting of the creditors of the above named bankrupt, having pursuant to notice, been duly held before the Honorable John J. Townsend, Referee in Bankruptcy, at his office 299 Broadway, in the Borough of Manhattan, City of New York, on the 12th day of April, 1922, at which time and place objections were made by the Trustee to the claim of the State of New York filed herein on the 3d of April, 1922, in the sum of five hundred thirty-five dollars and thirty-seven cents ($535.37) for a franchise tax for the period ending October 31, 1921, against the above named bankrupt corporation, and after due consideration the Referee herein having made an order on the 2nd day of November, 1922, allowing the claim of [fol. 35] the State of New York filed herein on the 3d of April, 1922, for a franchise tax for the period ending October 31, 1921, in the sum of four hundred forty-eight dollars and thirty-four cents ($448.34) for the principal of said tax, and interest upon said principal at the rate of one per cent (1%) a month from January 1, 1921, to the date of the payment of said tax in addition to the said principal sum and the Trustee herein having been aggrieved by said order, and having filed a petition with the said Referee to review said order, which said petition was verified on the 3d day of November, 1922, and the said Referee thereupon having filed his certificate on review in the office of the Clerk of this Court, and a hearing upon the Trustee's petition to review having been duly had before this Court on the 29th day of November, 1922, and after hearing Moses & Singer (Henry B. Singer, of counsel) for the Trustee in support of said petition to review, and the Attorney-General of the State of New York, by Charles P. Robinson, Deputy Attorney-General, of counsel, in opposition to said petition to review, and due deliberation having been had thereon, and the opinion of this Court having been duly rendered and filed herein on the 7th day of December, 1922, reversing the order under review made by the Referee and upon all the papers and proceedings heretofore had therein, it is

Upon motion of Moses & Singer, attorneys for the Trustee herein,

Ordered that the order made by John J. Townsend, Referee in [fol. 36] Bankruptcy, on the 2d day of November, 1922, allowing the claim of the State of New York filed herein on the 3d day of April, 1922, for a franchise tax for the period ending October 31, 1921, in the sum of four hundred forty-eight dollars and thirty-four cents ($448.34) for the principal of said tax, and interest upon said principal at the rate of one per cent (1%) a month from January 1, 1921, to the date of the payment of said tax in addition to the said principal sum, be and the same hereby is reversed; and it is further

Ordered that the franchise tax of the State of New York against the estate in bankruptcy of the above named bankrupt, as set forth in its proof of claim filed with the Referee herein on the 3d of April,

1922, be and the same hereby is apportioned, and the claim for such franchise tax filed by the State of New York herein with said Referee in the sum of four hundred forty-eight dollars and thirty-four cents ($448.34), be and the same hereby is apportioned so that the same is reduced to the sum of sixty-two dollars and twenty-seven cents ($62.27), representing the earned portion of said franchise tax for one and two-thirds ($1\frac{2}{3}$) months of the period of said tax, and that interest upon said claim as reduced to sixty-two dollars and twenty-seven cents ($62.27) be allowed at the rate of six per cent (6%) per annum from the 1st day of January, 1921, to the date of the payment of said tax as reduced and apportioned herein; and it is further

Ordered that said claim of the State of New York as apportioned [fol. 37] and reduced herein be allowed as a claim entitled to priority in payment out of the estate in bankruptcy of the above named bankrupt.

Augustus N. Hand, U. S. D. J.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

PETITION TO REVISE

To the honorable judges of the United States Circuit Court of Appeals, Second Circuit:

The petition of the People of the State of New York and the State Tax Department of the State of New York and the Attorney-General of the State of New York, respectively shows to this Court:

That on the 22d day of December, 1920, a petition in bankruptcy was filed against the Ajax Dress Company, Inc., in the District Court of the United States for the Southern District of New York, and thereafter the said bankrupt was adjudicated a bankrupt and the matter of the bankruptcy proceeding was referred generally to John J. Townsend, Esq., referee in bankruptcy of said District Court.

That on or about April 3, 1922, the People of the State of New [fol. 38] York and the State Tax Department filed with the referee in bankruptcy a claim for a State Franchise Tax based on the income of the calendar year 1919 at 4½ per cent, said tax being for the privilege of doing business for the year commencing November 1, 1920, and ending October 31, 1921, and being with the penal interest in the sum of $535.37.

At the final meeting of creditors of the above named bankrupt held before the said referee at his office on the 12th day of April, 1922, the trustee by his counsel made objection to the claim of the State of New York as filed and contended (1) that there should be an apportionment of the State franchise tax for the year beginning

November 1, 1920, as follows viz. that the tax claim should be allowed only for that portion of the year which elapsed between the beginning of the tax year, November 1, 1920, and the date of the filing of the petition in bankruptcy, December 22d, 1920; that the entire amount of the tax claim should thus be reduced proportionately as the elapsed period bore to the entire year, and (2) that the penal interest should not be allowed.

The referee wrote an opinion and made an order on the 2d day of November 1922, allowing the claim of the State of New York for franchise tax for the period ending October 31, 1981, in the principal sum of $448.34 and interest upon said principal sum at the rate of one per cent per month from January 1, 1921, to the date of the payment of said tax in addition to the said principal sum and the trustee having filed a petition to review the said order of the said ref- [fol. 39] eree and the said referee having thereupon filed his certificate on the review in the office of the Clerk of this Court and this matter having come on before Hon. Augustus N. Hand, United States District Judge, on the 29th day of November, 1922, an order was made by the United States District Court for the Southern District of New York on the 20th day of December 1922, reversing the order of John J. Townsend, referee in bankruptcy made on the 2d day of November, 1922. The said order of the United States District Court of the 20th day of December, 1922, provided that the claim of the State of New York for franchise tax be apportioned as urged by the trustee for the period of the year that elapsed between November 1, 1920, and the date of the filing of the petition in bankruptcy, December 22, 1820, or a period of one and two-thirds months of the taxable year. As so apportioned, the principal of the tax was reduced to the sum of $62.27, and the interest upon said claim was allowed at the rate of only six per cent per annum from the 1st day of January, 1921, to the date of payment and the said claim as apportioned and reduced was allowed as one entitled to priority of payment.

Your petitioners further avow that the said order or judgment or decree of the said District Court made and entered on the 20th day of December, 1922, was and is erroneous in matters of law in that the said District Court committed the following errors:

First. That the United States District Court for the Southern District of New York erred in reversing the order of the referee [fol. 40] dated November 2, 1922, and in apportioning the tax claim which was filed by the State Tax Department.

Second. That the said United States District Court for the Southern District of New York in its order reversing said order of the referee erred in so far as the said order found and decided that the tax could be apportioned for the period of the taxable year that elapsed prior to the filing of the petition in bankruptcy.

Third. That the said Court in its order (and opinion upon which said order was based) erred in holding that the franchise tax, claim for which was filed with the referee in bankruptcy, was one for

the actual exercise of a franchise and not for the privilege of exercising a franchise.

Fourth. That the said Court in its order reversing the order of the referee (in the opinion upon which the said order was based) erred in finding and deciding that this tax could be apportioned, notwithstanding the fact that the Statute Law of New York made the tax payable in advance.

Fifth. The said Court in its order reversing the said order of the referee and the opinion upon which the said order was based, erred in its failure to find that the said tax, claim for which was filed, was based upon the income for the calendar year 1919, as shown in the return made by this company to the United States Treasury, and was at the rate of 4½ per cent and was audited and stated by the State Tax Department for the privilege of doing business for the year commencing November 1, 1920, and ending October 31, 1921, and was payable in advance by the terms of the New York Statute.

[fol. 41] Sixth. That the said Court erred in reversing the said order of the said referee, in that it failed to recognize the lien created by the Statute Law of the State of New York for said tax from the time that it is payable until it is paid in full.

Seventh. The said Court erred in reversing the said order of the said referee in reducing the interest upon the said claim from one per cent a month to six per cent per annum, notwithstanding the fact that the Statute Law of the State of New York provides for interest at the rate of one per cent a month.

Wherefore, your petitioners, feeling aggrieved because of said order or judgment or decree, pray that the same may be revised in the matter of law by your Honorable Court, as provided in Paragraph 24b of the Bankruptcy Law of 1898, and the rules and practice in such case made and provided.

The People of the State of New York and the State Tax Department, by Charles D. Newton, Attorney-General.

Affidavit of Charles P. Robinson to above paper omitted in printing.

[fol. 42] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

PETITION FOR APPEAL AND ALLOWANCE

To the honorable, the judges of the United States District Court for the Southern District of New York:

The People of the State of New York and the State Tax Department, feeling aggrieved by the order and decree in the United States [fol. 43] District Court for the Southern District of New York, made by the Honorable Augustus N. Hand, one of the Judges thereof, entered herein on the 20th day of December, 1922, in the above entitled proceedings, reversing the order of John J. Townsend, Esq., referee in bankruptcy, dated November 2, 1922, and further apportioning a franchise tax audited and stated by the State Tax Department upon income for the calendar year 1919 for the privilege of doing business for the year commencing November 1, 1920, and ending October 31, 1921, for that period of the year that elapsed between November 1, 1920, and the date of the filing of the petition in bankruptcy herein, namely, December 22, 1920, does hereby petition for an appeal upon the said order and decree to the United States Circuit Court of Appeals for the Second Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings and evidence in said proceeding, duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the Second Circuit.

Dated, New York, December 22, 1922.

People of the State of New York and The State Tax Department, by Charles D. Newton, Attorney-General of the State of New York.

The foregoing appeal is hereby allowed December 28, 1922.
J. W. Mack, U. S. Circuit Judge.

[fol. 44] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

NOTICE OF APPEAL

SIRS: Please take notice that the People of the State of New York and the State Tax Department hereby appeal from the order and decree of the United States District Court for the Southern District of New York, made by the Honorable Augustus N. Hand, one

of the Judges thereof, and entered herein on the 20th day of December, 1922, reversing the order of Hon. John J. Townsend, referee in bankruptcy, dated the 2d day of November, 1922, and which order further apportioned a tax for that period of time that elapsed between the commencement of the year for the privilege of doing business, during which the tax had been audited and stated by the State Tax Department, and the date of the filing of the petition in bankruptcy, to the Circuit Court of Appeals for the Second Circuit, to be held in and for said Circuit at the United States Courts and [fol. 45] Post Office Building in the Borough of Manhattan, City of New York.

Dated, New York City, December 22, 1922.

Yours, etc., Charles D. Newton, Attorney-General of the State of New York, Office & Post Office Address 49 Chambers Street, Borough of Manhattan, City of New York. To Messrs. Moses & Singer, Attorneys for Trustee in Bankrupcy, 55 Liberty Street, New York City.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

ASSIGNMENT OF ERRORS

Now comes the People of the State of New York and the State Tax Department and file the following assignment of errors:

First. That the United States District Court for the Southern District of New York erred in reversing the order of the referee [fol. 46] dated November 2, 1922, and apportioning the tax, claim for which was filed by the State Tax Department.

Second. That the said United States District Court for the Southern District of New York in its order reversing said order of the referee, and the opinion upon which the said order was based, erred in so far as the said order and the opinion upon which it was based found and decided that the tax could be apportioned for a period of the taxable year that elapsed prior to the filing of the petition in bankruptcy.

Third. That the said Court in its order and opinion upon which said order was based, erred in holding that the franchise tax, claim for which was filed with the referee in bankruptcy, was one for the actual exercise of a franchise and not for the privilege of exercising a franchise.

Fourth. That the said Court in its order reversing the order of the referee and the opinion upon which the said order was based, erred in finding and deciding that this tax could be apportioned, not-

withstanding the fact that the Statute Law of the State of New York made the tax payable in advance.

Fifth. The said Court in its order reversing the said order of the referee and the opinion upon which the said order was based, erred in its failure to find that the said tax, claim for which was filed, was based upon the income for the calendar year 1919, as shown in the return made by this company to the United States Treasury, and was at the rate of 4½ per cent and was audited and stated by the State Tax Department for the privilege of doing business for the year com- [fol. 47] mencing November 1, 1920, and ending October 31, 1921, and was payable in advance by the terms of the New York Statute.

Sixth. That the said Court erred in reversing the said order of the said referee, in that it failed to recognize the lien created by the Statute Law of the State of New York for said tax from the time that it is payable until it is paid in full.

Seventh. The said Court erred in reversing the said order of the said referee in reducing the interest upon the said claim from one per cent a month to six per cent per annum, notwithstanding the fact that the Statute Law of the State of New York provides for interest at the rate of one per cent a month.

Wherefore, the People of the State of New York and the State Tax Department pray that the said order and decree herein for the manifest errors aforesaid, and for other errors in the record and proceedings herein, may be reversed and for naught held and esteemed; and that it may be restored to all matters and things which it has lost by reason of said order and decree, and that the United States District Court for the Southern District of New York may be directed to enter an order and decree herein affirming the said order of the said referee in bankruptcy.

Dated New York City, December 22, 1922.

Charles D. Newton, Attorney-General of the State of New York.

[fol. 48] CITATION ON APPEAL—Omitted in printing

[fol. 49] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

STIPULATION CONSOLIDATING APPEAL AND PETITION TO REVISE—Filed Jan. 5, 1923

It is hereby stipulated and agreed by and between the attorneys for the respective parties hereto that the appeal and the petition to

revise from the order of the United States District Judge Augustus N. Hand entered in the office of the Clerk of the United States District Court for the Southern District of New York on December 20, 1922, be consolidated and printed in one record and that the said appeal and petition to revise shall be heard upon said record as consolidated.

Dated: January 4, 1923.

Carl Sherman, Attorney-General of the State of New York and Attorney for the State Tax Department and the State of New York, Appellants. Moses & Singer, Attorney for Trustee and Appellee.

So ordered: Henry Wade Rogers, U. S. C. J.

[fol. 50] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

Record

STIPULATION ON APPEAL

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

Dated: January, 1923.

Carl Sherman, Attorney-General of the State of New York and Attorney for Appellants. Moses & Singer, Attorneys for Appellee.

[fol. 51] UNITED STATES OF AMERICA,
Southern District of New York, ss:

[Title omitted]

CLERK'S CERTIFICATE

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, do hereby Certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, this — day of January in the year of our

Lord one thousand nine hundred and twenty-three and of the Independence of the said United States the one hundred and forty-seventh.

Alex. Gilchrist, Jr., Clerk.

[fol. 52] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

Appeal from an Order in Bankruptcy Entered in the District Court for the Southern District of New York

OPINION

The petition against the above named bankrupt was filed 22d December, 1920, and adjudication duly followed.

Against the estate the State Tax Department filed a claim for a "franchise tax, for period ending October 31, 1921"; the amount claimed being

For tax	$448.34
"Penal interest, etc."	87.03
Total	$535.37

The bankrupt was a manufacturing or mercantile corporation of the State of New York. The tax claimed arises under Section 209 of the Tax Law of New York, which, so far as material, reads thus:

"Franchise Tax on Corporations Based on Net Income

For the privilege of exercising its franchise in this State in a corporate or organized capacity, every domestic manufacturing and every domestic mercantile corporation * * * shall annually pay in advance for the year beginning November 1st next preceding, an annual franchise tax, etc."

The bankrupt ceased actual business on the day of petition filed, so that it exercised its franchise something less than two months out [fol. 53] of the twelve months for which the tax was levied and leviable.

The Court below apportioned the tax and allowed of the claim a fraction which represented the portion of the year during which the bankrupt exercised its franchise.

As Ajax Co. had not compiled with the statute and paid the tax, the State claimed under Section 219-c of said tax law

"In addition to the amount of said tax, ten per centum of such amount plus one per centum for each month the tax remained unpaid".

The Court below denied this claim, treating it as a penalty, but allowed six per cent interest on the apportioned tax to the day of the date of actual payment by the Trustee.

From the order embodying this decision the present appeal was taken.

Robert P. Beyer, Deputy Attorney General of the State of New York, for appellants;

Henry B. Singer for the Trustee in bankruptcy.

HOUGH, C. J.: The question whether that which the State calls a tax is a tax and a proper tax, produces a federal question under the Bankruptcy Act (New Jersey vs. Anderson, 203 U. S., 483). Yet under familiar rulings, the construction of a state statute and the definition of its terms are matters on which we should ordinarily follow the authority of the highest state court.

Therefore we regard the first branch of this case as raising only the question whether it is or is not governed by People vs. Mutual Trust Co., 177 N. Y., 51.

In that case the operative words of the statute were that the said Trust Company, being incorporated under the law of New York—

[fol. 54] "shall pay to the State annually for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity an annual tax", etc.

The Trust Company organized on June 6, 1901, and opened for business on June 24th. A tax was levied for the year ending June 30, 1901, and the state demanded that for the privilege of transacting business for six days it should pay the same tax that it would have paid for doing business three hundred and sixty-five days.

Vann, J. pointed out that the demand for "an annual tax imposed annually", and for the privilege of "exercising not of possessing a corporate franchise". Further that it could not "exercise its franchise for the entire year because the state did not bring it into existence until the year had nearly expired". The consideration for the tax was the privilege of carrying on business; yet the state was endeavoring to require the relator to pay for a privilege that it "could not exercise during the greater part of the period for which the tax was laid". Further, said the Court, an annual tax imposed annually meant a tax "imposed once a year computed by the year"; and the tax was "measured by an annual business done".

It was further pointed out that in People vs. Spring Valley Co., 92 N. Y., 383, there (and here) relied upon by the state,—the question of apportionment had been raised neither by the pleadings nor at trial, and although sought to be raised in the court of last resort, was not considered for obvious reasons.

The question now at bar is whether, since the present statute requires a corporation to pay the tax "annually in advance", the rea-

sons for the Mutual Trust Co. decision have been swept away by changing the language of the statute.

[fol. 55] Every reason advanced by the court in the Mutual decision is applicable here. The requirement to pay "annually in advance" is directory only; the tax was the same tax on the day of petition filed that it was on the first of November. Undoubtedly the state may exact a price for beginning a year's business, or charge the same price for the privilege of transacting business one day or one year. The question is not one of power, but of language, and we are of opinion that the changed language has not changed the nature of the tax. Comparing the Mutual case with this;—both taxes are franchise taxes; both are measured by business or the means of doing business; both are for the exercise of a franchise; neither is for the possession of a franchise, nor is either a price exacted on giving a franchise; in both the contemplation of law is that the franchise shall cover the business done thereunder for a year.

For these reasons we follow the Mutual decision in holding that the tax was properly apportioned below. The case of New York Terminal Co. vs. Gaus, 204 N. Y., 512, is not applicable; there a receiver had exercised the taxable franchise, and was held taxable thereon and therefor. Nothing of the sort is here suggested.

The inability of the Mutual Company to exercise its franchise for the yearly period was caused by non-existence; the inability of Ajax Co. to do the same, is caused by deprivation through bankruptcy of all means of exercising the privilege; the business and logical result is the same. The somewhat sardonic suggestion, that had Ajax Co. paid the tax and gone out of business or into bankruptcy in a few days, there would have been some difficulty in getting a rebate from the State, is not persuasive in law, though quite true in practice.

[fol. 56] So far as the state's second demand, for penalties and interest is concerned, the matter is covered by our opinion in Re Menist, filed today. That decision relates to a claim for interest at one per cent per month made by the United States in respect of its demand for lawful and unpaid taxes; but whatever is there said is applicable with equal force to the demand of the State of New York, nor only for one per cent a month, but for what is confessedly a penalty and called by that name.

Order affirmed with costs.

[fol. 56½] [File endorsement omitted.]

[fol. 57] At a Stated Term of the United States Circuit Court of Appeals in and for the Second Circuit Held at the Court Rooms, in the Post Office Building, in the City of New York, on the 16th Day of April, One Thousand Nine Hundred and Twenty-three.

[Title omitted]

Appeal from the District Court of the United States for the Southern District of New York

Decree

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged and decreed that the order of said District Court be and it hereby is affirmed with costs.

C. M. H.
M. T. M.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

[fol. 58] [File endorsement omitted]

[fol. 59] Clerk's Certificate

United States of America,
Southern District of New York, ss:

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby Certify that the foregoing pages, numbered from 1 to 58 inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Ajax Dress Company, Bankrupt, State of New York and State Tax Department, Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 25th day of April, in the year of our Lord One Thousand Nine Hundred and twenty-three and of the Independence of the said United States the One Hundred and forty-seventh.

Wm. Parkin, Clerk. [Seal of the United States Circuit Court of Appeals, Second Circuit.]

[fol. 60] WRIT OF CERTIORARI AND RETURN—Filed July 7, 1923

UNITED STATES OF AMERICA, ss:

[Seal of the Supreme Court of the United States.]

The President of the United States of America to the Honorable the Judges of the United States Circuit Court of Appeals for the Second Circuit, Greeting:

Being informed that there is now pending before you a suit entitled In the matter of Ajax Dress Company, Inc., Bankrupt, wherein The State of New York and State Tax Department are appellants, and Louis Jersawit, Trustee in Bankruptcy, is appellee, which suit was removed into the said Circuit Court of Appeals by virtue of an appeal from the District Court of the United States for the Southern District of New York, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Supreme Court of the United States, Do hereby command you that [fol. 61] you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable William H. Taft, Chief Justice of the United States, the Twenty-third day of June, in the year of our Lord one thousand nine hundred and twenty-three.

Wm. R. Stansbury, Clerk of the Supreme Court of the United States.

[fol. 62] [File endorsement omitted.]

[fol. 63] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

Whereas the Supreme Court of the United States has heretofore granted the petition of the Petitioner-Appellant of the State of New York for a writ of certiorari to review the record in the above cause, and under date of June 23" 1923, issued its writ of *of* certiorari, directing the above court to send to it the record and proceedings in the above cause, and certified copy of said record and proceedings having heretofore been lodged in said court by the petitioner-appellant, now

It is hereby stipulated by and between the parties to the above entitled action that the certified copy of the record in the above case heretofore filed in the Supreme Court of the United States by the

petitioner-appellant, as a part of its petition as a writ of certiorari may be taken as the return to the writ of certiorari issued by the Supreme Court of the United States, and that when this stipulation may have been filed with the Clerk of the United States Circuit Court of Appeals for the Second Circuit, a certified copy thereof may be forwarded by him to the Clerk of the Supreme Court of the United States, as his return to the writ of certiorari, issued out of the Su-[fol. 64] preme Court of the United States on the 23 day of June, 1923.

Dated: New York, June 30, 1923.

Carl Sherman, Attorney General, By Robert P. Beyer, Attorney for Petitioner-Appellant. Moses & Singer, By Henry B. Singer, of Counsel, Attorneys for Respondent.

[fol. 65] To the Honorable the Supreme Court of the United States, Greeting:

The record and all proceedings whereof mention is within made, having lately been certified and filed in the office of the clerk of the Supreme Court of the United States, a copy of the stipulation of counsel is hereto annexed and certified as the return to the writ of certiorari issued herein.

Dated, New York, July 3, 1923.

Wm. Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit. [Seal of the United States Circuit Court of Appeals, Second Circuit.]

[fol. 66] [File endorsement omitted.]

[fol. 67] [File endorsement omitted.]

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No. 1110

Supreme Court of the United States

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioner,

vs.

LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS CO., INC.,
Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

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CARL SHERMAN,
Attorney General,
Albany, N. Y.

ROBERT P. BEYER,
C. T. DAWES,
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New York City, N. Y.

BATAVIA TIMES, LAW PRINTERS,
BATAVIA, N. Y.

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Supreme Court of the United States

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioner,
against
LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS COMPANY, INC.,
Respondent.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, the People of the State of New York, respectfully shows to this Honorable Court:

First: That there is pending in the District Court of the United States for the Southern District of New York, a certain bankruptcy proceeding entitled "In the Matter of Ajax Dress Co., Inc., Bankrupt," arising out of the filing of a petition in bankruptcy against the Ajax Dress Co., Inc., on the 22nd day of December, 1920. The said Ajax Dress Co., Inc., was duly adjudicated a bankrupt and the matter of the bankruptcy proceeding was referred generally to John J. Townsend, Esq., referee in bankruptcy of said District Court. The respondent Louis Jersawit was duly selected trustee of said bankrupt.

Second: That on or about April 3rd, 1922, the petitioner, The People of the State of New York filed with the referee in bankruptcy a claim for franchise tax based on the income of the bankrupt for the calendar year 1919 at 4½ per cent, said tax being for the privilege of doing business for the year commencing November 1st, 1920, and ending October 31st, 1921, as follows:

State Franchise Tax

On business corporations under Article 9-A of the Tax Law as amended:

For period ending October 31, 1921:

Tax based on income 4½%	$448.34
Penal interest, etc.	87.03
Total	$535.37

Third: That Section 209 of the Tax Law of the State of New York under which said tax arose, provides as far as material as follows:

> "Sec. 209. *Franchise tax on corporations based on net income.* For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section, shall annually pay in advance for the year beginning November first next succeeding the first day of July in each and every year an annual franchise tax, to be computed by the tax commission upon the basis of its entire net income for its fiscal or the calendar year next preceding, as hereinafter provided. which entire net income is presumably the

same as the entire net income upon which such corporation is required to pay a tax to the United States,"

Fourth: The rate of the tax is fixed by §215 of the Tax Law, providing that the tax shall be at the rate of four and one-half per centum of the entire net income of the corporation or the portion thereof taxable within the State.

Fifth: Section 219-c of the Tax Law of the State of New York provides that the tax shall be paid to the State Tax Commission on or before the first day of January of each year, and that, if the tax be not so paid

> "the corporation liable for such tax shall pay to the State Tax Commission, in addition to the amount of such tax, ten per centum of such amount, plus one per centum for each month the tax remains unpaid. * * *
>
> *Each such tax or additional tax shall be a lien upon and binding upon the real and personal property of the corporation liable to pay the same until the same is paid in full.*"

Sixth: At the final meeting of the creditors of the above-named bankrupt held before the referee at his office on the 12th day of April, 1922, the trustee, by his counsel, made objection to the claim of the petitioner, the People of the State of New York as filed and contended:

> 1. That there should be an apportionment of the State franchise tax for the year beginning November 1, 1920, as follows: viz., that the tax claim should be allowed only for

that portion of the year which elapsed between the beginning of the tax year, November 1, 1920 and the date of the filing of the petition in bankruptcy, December 22, 1920, and that the entire amount of the tax claim should thus be reduced proportionately as the elapsed period bore to the entire year.

2. That the statutory interest should not be allowed.

SEVENTH: The referee held, in disposing of the objections that the tax assessed against the bankrupt, being under statute directed to be paid in advance, based upon income earned in the State during the preceding year was not apportionable and must be paid in full; and that under the law as established *in Re:* Kallak, 17 A. B. R., 415, 147 Fed. Rep., 276; *In Re:* G. L. Schuyler & Co., 21 A. B. R., 428; *Re:* Scheidt & Brother, 23 A. B. R., 778, 187 Fed. Rep., 599; *Re:* Ramirez-Quinones, 39 A. B. R., 323, U. S. vs. Guest, 143 Fed. Rep., 456, the statutory exaction made by the statute for non-payment of the tax should be construed as prescribing interest and not as imposing a penalty. The referee refused to follow a decision to the contrary rendered *in Re:* Ashland, Emery & Conindom Co., 36 A. B. R., 194, 229 Fed. Rep. 829. A referee's order was accordingly entered on November 2, 1922, ordering that the claim of the State of New York filed on the 3rd day of April, 1922 for a franchise tax for the

period ending October 31, 1921 be allowed in the sum of $448.34 for the principal of said tax, and interest upon said principal at the rate of 1% per month from January 1, 1921 to the date of the payment of said tax in addition to the said principal sum, and that the said claim be allowed as one entitled to priority of payment.

EIGHTH: Thereafter, the trustee in bankruptcy duly filed a petition to review the said order of the referee and obtained a certificate of the referee on said petition under date of November 23, 1922, certifying the determination made by the referee as stated, and the papers and proceedings upon which the said determination was based. A hearing upon said petition and certificate was duly held by the United States District Court for the Southern District of New York, Justice Augustus N. Hand, United States District Judge, presiding, on the 29th day of November, 1922. United States District Judge, Augustus N. Hand, rendered an opinion, holding that the tax due and owing to the People of the State of New York should be apportioned as prayed for by the trustee in bankruptcy, and following the decision *in re.*, Ashland, Emery & Conindom Co., 36 A. B. R., 194, 229 Fed. Rep. 829, refusing to follow the other decisions mentioned in the opinions of the referee, and further holding that the interest be allowed to the petitioner, The People of the State of New York, on its tax

claim as apportioned, be at the rate of 6% per annum to the date of payment. An order of the District Court for the Southern District of New York reversing the referee's order in the manner and form stated was duly entered on the 20th day of December, 1922.

NINTH: Your petitioner thereupon prosecuted an appeal to the United States Circuit Court of Appeals for the Second Circuit, as well as presenting to said court a petition to revise the said order of the United States District Court for the Southern District of New York on seven assignments of error duly filed which related to the action of the District Court of the United States for the Southern District of New York in apportioning its tax claim as filed in the manner as stated and in reducing the interest rate allowed by the referee to 6% per annum. The said appeal was duly argued in said Circuit Court of Appeals for the Second Circuit during the April term of said court, and on April 23, 1923, a decision was duly entered, affirming the decree of the said District Court of the United States for the Southern District of New York. Thereafter, and on or about the day of April, 1923, a mandate of the said United States Circuit Court of Appeals for the Second Circuit was duly filed in the District Court of the United States for the Southern District of New York.

TENTH: Your petitioner believes that the foregoing decree of the Circuit Court of Appeals of the United States for the Second Circuit is erroneous and based upon a state of law no longer existing in the State of New York as expressly decided by our Court of Appeals in a decision not noticed by the lower federal courts (Peo *ex rel.*, N. Y. C. R. R. v. Gans, 200 N. Y. 328) and that this Honorable Court should require that this said case be certified to it for its review and determination in conformity with the provisions of the Act of Congress in said cases made and provided on the following grounds:

1. That this case involves construction of the statutes and judicial decisions of the State of New York relative to the payment of taxes in advance, and the recognition of interest exactions expressly provided for by the statute law of the State of New York, and that the determination made by the United States Circuit Court of Appeals for the Second Circuit is contrary to and subversive of the expressed language of the statute of the State of New York, relating to taxation and the decision of the courts of the State of New York in the interpretation of such statute.

2. That there exists diversity of judicial decisions relative to the correct determination of the questions at issue. That the Circuit Court of Appeals for the Fourth Circuit,

which the referee followed in this case, as well as the other Federal decisions mentioned in the opinion of the referee have determined the question as to the allowance of statutory interest accruing, and interest and tax payments contrary to the authority relied upon by both the District Court and the Circuit Court of Appeals in the instant case, and that necessity exists for finality of determination of this question by this court so that a unanimous determination applicable to all circuits may be arrived at.

3. That the judgment of the Circuit Court of Appeals for the Second Circuit, in disposing of the question as to the apportionability of franchise taxes imposed upon corporations under the provisions of the tax law of the State of New York, is in conflict with the decisions of the State of New York and based upon a misapprehension of what the courts of your petitioner have decided in respect to the question at issue; that the decision of the Circuit Court of Appeals for the Second Circuit entirely misconstrued the meaning and intent of Section 209 of the tax law, and that under the decisions of the State of New York as well as the decisions of this court rendered in the matter of New Jersey vs. Anderson, 203 U. S., 483, the Circuit Court of Appeals of the Second Circuit should have reached the same conclusion as

the referee did before whom the case was originally heard.

4. That the said decision of the Circuit Court of Appeals for the Second Circuit, if allowed to stand, would deprive the statutes of the State of New York of all practical effect, and erroneously limit the scope of such statute, and seriously affect the taxing power of your petitioner. That the questions to be finally determined by this court are material, not alone in the instant case, but in every case of bankruptcy in which the bankrupt is a corporation. In every such bankruptcy case, arising in any of the districts of the State of New York, a franchise tax is due by the bankrupt to the State. If the decision of the Circuit Court of Appeals for the Second Circuit be allowed to stand, in every such bankruptcy proceeding, the claim of the State will be affected in like manner as in the instant case, and will necessarily be ordered apportioned, both as to principal and interest in the same manner as was done by the Circuit Court of Appeals for the Second Circuit, with consequent loss to the State of New York of thousands upon thousands of dollars. In view of this fact, and the reason that conflict of authority exists in various circuits, your petitioner submits that this case is one of such importance as to merit final adjudication by this court so that the

procedure relating to tax claims in bankruptcy matters may be finally and conclusively determined.

ELEVENTH: A certified copy of the entire record of said case is herewith furnished as part of this application in conformity with rule 37 of this Honorable Court relative to cases from the Circuit Court of Appeals and the same is marked, Exhibit "A".

WHEREFORE your petitioner respectfully prays that a writ of certiorari may be issued out of and under the seal of this court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that court to certify and send to this court on a day certain to be therein designated, a full, true and complete transcript of the record and of all proceedings in said Circuit Court of Appeals in the said cause therein, entitled "In the Matter of Ajax Dress Company, Bankrupt,—State of New York and State Tax Department, appellants, against Louis Jersawit, Trustee in Bankruptcy, appellee", to the end that the said cause may be reviewed and determined by this court as provided in Section 6 of the Act of Congress, entitled "An Act to Establish a Circuit Court of Appeals and to define and regulate in certain cases the jurisdiction of the court of the United States, and for other purposes", approved, March 3, 1891. (26 Stat. 826, Chap. 517), and

that your petitioner may have such other and further relief or remedy in the premises as to this court may seem appropriate and in conformity with the said act, and that the said decree of the United States Circuit Court of Appeals for the Second Circuit in said case and every part thereof may be reversed by this Honorable Court.

And your petitioner will ever pray.

THE PEOPLE OF THE STATE OF N. Y.,
Petitioner.

By CARL SHERMAN,
Attorney General of the State of N. Y.,
Office and Post Office Address,
Capitol, Albany, New York.

ROBERT P. BEYER,
C. T. DAWES,
Counsel for Petitioner,
49 Chambers Street,
Borough of Manhattan,
New York City, N. Y.

State of New York, }
City of New York, } ss.:
County of New York. }

ROBERT P. BEYER, being duly sworn, deposes and says:

That he is a Deputy Attorney General of the State of New York, and is counsel for the petitioner herein. That he has prepared the foregoing petition, and that the allegations therein are true as he verily believes.

ROBERT P. BEYER.

Subscribed and sworn to before
me this 26 day of April, 1923.
Alfred W. Jones,
Commissioner of Deeds, City of New York.
New York (Clk. 50-Reg. 23923) Kings.
(Clk. 45-Reg. 3912,) Bronx (Clk. 4-Reg.
3892) Queens 3487 and Richmond.
Commission expires May 24th, 1923.

SUPREME COURT OF THE UNITED STATES.

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioner.

against

LOUIS JERSAWIT, as trustee in Bankruptcy of AJAX DRESS COMPANY, INC.
Respondent.

Brief of Petitioner, the People of the State of New York, in Support of the Petition for Writ of Certiorari.

Petitioner, the People of the State of New York petitions this Honorable Court to review by certiorari an order of the Circuit Court of Appeals for the Second Circuit made final under Section 7 of the Act of Congress, entitled "An Act to Establish a Circuit Court of Appeals and to review and regulate in certain cases the jurisdiction of the Courts of the United States and for other purposes," approved March 3, 1891 (26 Stat. 826, Chap. 517).

The petitioner shows as set forth in the petition, that this case involves two questions which it is of the utmost importance to have finally determined, questions that arise in every bankruptcy proceeding in which the bankrupt is a corporation.

Under Section 209 of the Tax Law of the State of New York, it is provided that every domestic corporation, and every foreign corporation doing business in the State of New York, shall pay annually in advance, on the first day of November of each year a tax of 4½% of the amount of net income earned by said corporation in the State of New York for the preceding year. Such tax is required to be paid on or before the first day of January, succeeding the said November 1st. The statute further provides that in case the tax be not paid on or before January, that there shall be added 10% to the amount of such tax and 1% per month from the date of assessment to the time of payment thereof. The corporation, in the instant case, was adjudicated a bankrupt on December 20, 1920. The contention is made that the corporation should therefore only pay such proportion of the tax assessed by the State of New York as the period from November 1st to December 20th bears to the entire calendar year and that there should be an apportionment of the tax accordingly. The contention is further made that the statutory exaction of interest specified by the statute is in effect a penalty which should not be allowed by the bankruptcy court, and that only interest at the rate of 6% per annum should be allowed upon the claim of the state, reduced in the manner as stated. These objections presented by the trustee in bankruptcy were respectively overruled by the referee, before whom the matter in the first instance came for determination. The

District Court of the United States for the Southern District of New York and the Circuit Court of Appeals for the Second Circuit however took a contrary view to that of the referee and sustained both objections to the claim of the state as made by the trustee in bankruptcy.

The protection which should be accorded to the state in the conservation of its taxing powers has been already announced by this court. In Marshall vs. the people, 254 U. S., 380, this court permitted a certiorari to issue to the United States Circuit Court of Appeals for the Second Circuit, so that the matter of state priority in the collection of tax obligations could be finally determined, and this court in holding, in this decision, that the state is entitled to be paid the amount of tax obligations due it as a priority creditor because of its sovereign capacity, has fully recognized the principle that is of the utmost importance to the stability of government, that the state be protected to the utmost in securing that revenue upon which the ability to govern depends. This same principle is controlling in the decision of this court in the case of New Jersey vs. Anderson, 203 U. S., 483, construing the tax statute of the State of New Jersey. This court held in said authority that the state creating a corporation may fix the terms of its existence, and provide that for the continued exercise of its franchise it must yearly pay the state certain sums fixed by the amount of its outstanding stock. In that case, the franchise

tax due by the corporation was payable on January 1st of each year for the ensuing year. The corporation was adjudicated a bankrupt on April 23, 1903, a little over four months after the tax was payable. This court held that the tax must be paid in full, even through no specific lien against the property of the corporation attached when the corporation went into bankruptcy. Mr. Justice Day of this court stated, page 494:

> "The amount claimed for the year 1903, it is insisted had not accrued at the time the adjudication in bankruptcy, which was on April 23, 1903, the return being made on May 2, 1903 and the assessment was not made until July 1, 1903; but the actual return required to be made to the board on or before the first Tuesday in May is upon the basis of the capital stock issued and outstanding, as of January, preceding the making of the return. The Bankruptcy Act requires the payment of all tax legally due and owing. We think the tax thus assessed upon that basis was legally due and owing, although not collectable until after the adjudication."

The New York statute is similar to that of the New Jersey statute as to the specific income of the corporation upon which the return to the state is to be measured. The franchise tax levied by the State of New York is based upon a percentage of the income earned in the state for a preceding year to November 1st of each year. The New York statute prescribes clearly that the tax thus assessed upon that basis legally due and owing on November 1st, and grace is given to the cor-

poration affected to pay the tax without penalty on or before January 1st succeeding. There is nothing in the statute relative to any apportionment of the tax thus levied, and the plain reading in the language of the statute negatives any possibility of any such construction thereof.

Reliance by the Court below upon the wrong state authority.

The Circuit Court of Appeals for the Second Circuit, on this question, relied upon the case of People vs. Mutual Trust Co., 177 N. Y. 51, which construed present Section 188 of the tax law of the State of New York relating to franchise tax on trust companies, and which provides that "Every Trust Company incorporated, organized or formed under, by or pursuant to a law of this state * * * shall pay to the State annually for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity, an annual tax which shall be equal to one per centum on the amount of its capital stock, surplus, and undivided profits."

By relying upon this early Mutual Trust Company case the Circuit Court of Appeals has misunderstood the present state of law in New York. The Court of Appeals of our state has directly shown the inapplicability of the Mutual Trust Company case to the present system of taxation, and it has done so by a full discussion

of the Mutual Trust Company case. We are referring to the later decision in People *ex rel.* N. Y. C. & H. R. R. R. Co. vs. Gaus, 200 N. Y. 328, a decision not commented upon by the Circuit Court of Appeals or by Judge Hand. In the New York Central case the tax was payable in advance, while in the Mutual Trust Company case the tax was payable for the past year. Speaking of its determination in the first case and showing the difference between the two taxes the Court said, at page 330:

> "this court held in *People ex rel. Mutual Trust Co. v. Miller* (177 N. Y. 51), where the relator began business a few days before the end of the tax year, that it was only the average outstanding stock during the year which was to be taken as the basis of the tax. In that case we treated the franchise tax as an exaction *for the privilege afforded to the corporation for the past year. After our decision, however, the legislature amended section 182 of the Tax Law so as to provide that the tax should be paid in advance. The amendment changed the character of the tax as to corporations embraced within that section, from a payment for past privileges already enjoyed to a payment for privilege to be enjoyed in the following year.* Trust Companies are not taxed under section 182, but under section 187a. While the tax in each case is a franchise tax and so regarded in law, there is a very marked distinction between the two. The tax imposed on corporations generally under section 182 amounts to 1½ mills on the capital stock of a corporation paying 6% dividends, and its payment does not exempt the corporation from local or

property taxes. On the other hand, the tax on a trust company is 1%, and relieves the company from all other taxation. *After the amendment of section 182, the grounds on which we placed our decision in the Mutual Trust Co. case became no longer applicable to corporations taxed under that section.* But that amendment in no way affected corporations taxed under section 187a, where a very different tax is imposed. For this reason our decision in the Mutual Trust Co. case, so far as it related to trust companies, remained unaffected. Subsequently there arose the case of People *ex rel.* Lincoln Trust Co. v. Glynn (132 App. Div. 546), the decision in which was affirmed by this court on the opinion below in 198 N. Y. 501. In that case it was held that the method of taxation of trust companies had not been altered by the change in the law. *The distinction between the two cases was clearly pointed out* in the opinion of the learned Appellate Division."

All of the foregoing was unnoticed by the Circuit Court and by Judge Hand, and it is doubtful whether the lower courts appreciated the existence of the opinion in the New York Central case.

The District Court refers also in its opinion to People *ex rel.* Lehigh and New York Railroad Co. vs. Sohmer, 217 N. Y. 443, where Section 182 of the Tax Law as it then read was under review. Section 182 of the Tax Law considered by the court in said case, reads radically different from Section 209 of the Tax Law in the instant case, in that the words in section 182 "for the privi-

lege of doing business or exercising its corporate franchise in this State" were at the time the Lehigh case was before the courts qualified by the repetition of the words "doing business in this State." In other words, both a domestic corporation as well as a foreign corporation had at that time *to be doing business* before a tax accrued. After the decision in 217 N. Y. 443, and because of it the legislature amended Section 182 of the tax law, eliminating the words "doing business" when applicable to domestic corporations. The legislature has therefore given clear expression of its intent, that it changed the ruling as made by the Court of Appeals in 217, N. Y. 443, and that the doing of business in the case of a domestic corporation was not to be considered as affecting the tax accruing under section 182 of the tax law. In like manner, the legislature has provided, in Section 209 of the tax law, that the doing of business in this state had no relation to domestic corporations such as the bankrupt herein or as to its privilege of exercising its franchise in this State in a corporate or organized capacity. The reason for the tax and the actual privilege taxed are stated differently for a domestic corporation and for a foreign corporation, the tax for a domestic corporation is for the privilege of "exercising its franchise in this state in a corporate or organized capacity," and the tax for a foreign corporation is for the privilege of "doing business in this state":

"Sec. 209. *Franchise tax on corporations*

based on net income. For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section shall annually pay in advance for the year beginning November first next succeeding the first day of July in each and every year an annual franchise tax, to be computed by the tax commission upon the basis of its entire net income for its fiscal or the calendar year next preceding, as hereinafter provided, which entire net income is presumably the same as the entire net income upon which such corporation is required to pay a tax to the United States, * * *."

The tax is directed to be paid on the basis of income earned during the preceding year and was expressly directed to be paid in advance of the ensuing calendar year. Neither the basis upon which the tax was calculated nor the time of payment has any reference to business to be transacted thereafter. It is akin to a license fee or income tax based upon benefits theretofore derived in the State as a condition for permission to continue to exercise such privilege or franchise for a succeeding year. It was a measure of valuation adopted by the legislature so that the franchise could be uninterruptedly exercised and its value at all times definitely determined (People vs. Barcalo Mfg. Co. vs. Knapp, 227 N. Y. 64).

This question was construed in New York Terminal Co. vs. Gaus, 204 N. Y., 512, where prop-

erty of a corporation was operated by a receiver during which period of operation franchise taxes for the privilege of doing business or exercising corporate franchises were levied by the State. The property of the corporation was sold by the receiver during the tax period under foreclosure. It was held that the lien of the tax continued in its entirety.

Likewise in the case of Marshal, 254 U. S., 380. There was no suggestion of an apportionment; and in that case the District Court allowed the full amount of the franchise tax without apportionment.

The case of New York Terminal Co. vs. Gaus was followed by this Court in Penn. Steel Co. vs. The New York City Railway Co., 198 Fed. Rep., 768. Judge Ward, page 771, stated:

> "These taxes were made a lien by Section 197 of the Tax Law, and although we have held under the similar Federal Law, (Chapter 6, Laws of 1909), that they are not payable by receivers, the Court of Appeals of the State of New York has held that a similar tax under Section 182 of the New York Tax Law is payable by the receivers and remains a lien on the premises after sale and foreclosure, New York Terminal Co. vs. Gaus, 204 N. Y., 512. We feel obliged to follow this decision and to hold that the purchaser take the premises subject to the tax."

The real purpose of the franchise tax enacted by Section 209 of the Tax Law further appears

from the decision in People *ex rel.* Cornell Steamboat Company vs. Sohmer, 206 N. Y., 651, in which case Cullen, J., stated:

> "I doubt whether in the true sense of the term it is to be considered a tax, but should not rather be deemed a compensation, exacted for the privilege which the State might refuse. If the parties beneficially interested in the appellant are dissatisfied with the price exacted by the State they may have the corporation dissolved and as individuals carry on the same business that is being done now without the cost of any such charge."

The laws of the various states, particularly that of the State of New York, furnish innumerable instances where a particular trade or calling or the performance of particular acts, is required to be licensed, and where one of the conditions of obtaining such license is the payment of a fee covering a particular license period. Various illustrations are found under the general business laws of the State of New York, relating to the licensing of auctioneers, peddlers, junk-dealers, private detectives, warehousemen, employment agencies and moving picture exhibitions; under the general Highway Law, relating to the registration and licensing of motor vehicles; under the Charter of the City of New York, creating the license bureau of the City of New York, which has jurisdiction over various other forms of business activities. It is academic that where a license is granted upon payment of the legal fee covering a stated period that no refund of such

license is permissible, even though the licensee does not avail himself of the privilege conferred for the entire license period.

(Hart vs. Beauregard, 22 L. A. Ann., 80.)

Other instances of non-apportionment of a debt payable in advance for a certain privilege conferred, is afforded by leases, which provide that rent for certain periods should be paid in advance. It has been determined by this court and other Federal courts, in bankruptcy that where such is the case the claim of the landlord can be proven for the amount of the stipulated rental payable in advance, even though the tenure of the term covered by said rent should have been interrupted by bankruptcy proceedings (*re* Pittsburgh Drug Co., 164 Fed. Rep., 162; McCann vs. Evans, 185 Fed. Rep., 93; *Re* Sherwoods, 210 Fed. Rep., 754; *Re* Scruggs, 205 Fed. Rep., 673).

The tax due to the State of New York was due November 1, 1920. The payment thereof, made it lawful for the corporation to continue to exercise its franchise for the ensuing year. It recognized the liability for the tax by taking advantage of the privilege conferred by the State in continuing to exercise its franchise after the tax had accrued. The State is not interested to what extent the privilege conferred is exercised. Any act done by the corporation under the privilege conferred makes it amenable to respond to a tax of this nature which, by statute, is expressly stated

to be paid in advance. There is nothing in the statute relative to any apportionment of the tax thus levied. In the absence of any statutory direction, no apportionment can be decreed by the Court.

The inequitableness of apportioning or prorating a tax is pointed out in the case of Archibald McNeil & Sons Co. *et al.*, vs. Bay State St. Ry. Co., 282 Fed. 338. In that case the tax was based on the gross earnings for a complete year and the court says:

> "By the statute the computation of the tax is based on the return of the street railway company. In certain details, which might change from month to month, it has been definitely held by the Supreme Judicial Court that there could be no prorating or adjusting; that the intent of the statute was that the assessment should be based on the facts as they exist on September 30. See N. & C. Street Railway vs. Wellesley, 207 Mass. 514, 93 N. E. 834. There is no provision in the statute for prorating the tax between different operating companies when there has been a change of ownership during the tax year; nor is there any requirement that a company not operating on September 30th shall file a return. The tax is based on gross earnings for a complete year. It disregards operating expense. During the winter months, operating expenses are apt to be much heavier than during the summer. Taxing the gross receipts of the company (or person) which operated during the winter the same as the one operating only during the summer might be unjust to the former."

The reasoning of the court in the above case applies as well to the instant case where the tax is based on net income as where it is based on gross earnings. The net income of corporations vary materially each month, depend to some extent on the character of the business conducted. Some corporations have little net income during the winter months; others enjoy their greatest return at that season of the year. Some have their greatest prosperity in the summer months, while others do not.

It is plain therefore, that to adopt a straight line method of apportionment irrespective of the net income of the corporation during the months apportioned, would ofttimes be unjust and inequitable and furthermore contrary to the intention of the legislature.

It is of the utmost importance in the proper administration of the bankruptcy law that the question involved as above be definitely settled by this court. While the amount involved in the instant case is small, the precedent established by the Circuit Court of Appeals for the Second Circuit will apply to every bankruptcy in which a corporation is a bankrupt. In every such instance where a bankruptcy occurs during some part of the year for which a franchise tax is payable and in every case there will be a similar apportionment of the tax as made in the instant case. If the decision stands, it will mean a loss to the State of New

York of thousands upon thousands of dollars, and other States having similar statutes will be likewise affected. The decision rendered by the Circuit Court of Appeals for the Second Circuit is clearly in conflict with the decision of this court rendered in the matter of State of New Jersey vs Anderson, supra, and the importance of the question well merits correction of the erroneous ruling made by the Circuit Court of Appeals of the Second Circuit, through the alllowance of the certiorari as prayed for in the petition.

The Circuit Court of Appeals for the Second Circuit has further determined that the statutory rate for delinquency of payment of the tax was a penalty and should be disallowed, and that only 6% interest per annum should be allowed upon the taxes apportioned to the day of the date of actual payment by the Trustee, following a decision it made contemporaneously with the decision of the Ajax Dress Co., involving construction of a Federal statute, conferring similar statutory interest upon tax due the United States Government. *Re:* Menist—In the Menist case, the court refused to follow the decision *in re.* Kallak, 147 Fed. 276; Scheidt 177, Fed. 599; *Re:* Quirnes, 39 A. B. R., 320; and followed *in Re:* Ashland, 229 Fed. 829.

From the opinion, it clearly appears that the question under consideration is one upon the true

determination of which various circuits have differed. The decision rendered by the Circuit Court of Appeals for the Second Circuit is contrary to the true principle to be applied for the determination of this question.

In the case of People vs. The Gold & Stock Telegraph Company, 98 N. Y., 67, it was held that it was error, on non-payment of a franchise tax due to the State of New York to allow interest on the tax at six per cent per annum, the Court holding that the statute prescribed the exaction for default in payment and no other additional amount could be collected. The court per Danforth, J., stated, page 79:

> "The State at its pleasure created the charge or tax, and prescribed the penalty for default of payment. No other can be collected. In this case the Comptroller is directed to add 'ten percentum to the tax of said corporation or company * * * for each and every year for which such tax shall not have been paid' (Sec. 2) and by Section nine an action is given to the People for tax imposed. Interest is not given either by this act or by any general law of the State. The payment of which cannot be imposed by implication. What the State omitted to demand, the Court cannot require. But the legislature has not overlooked in this respect any property right of the State. Where interest is given, it is as damages or compensation for delay in payment. The creditor is supposed to have lost something and to acquire indemnity. Here the legislature has ordained it. Ten per cent annually is to be added. Whether it lay in

> the mind of the legislature that this was interest or not, we do not know. It is what is given; and that it is given and nothing more, excludes any plausible contention that the taxpayer is liable beyond it."

That no interest other than as prescribed by the Legislature is collectible by the State upon delinquency in the payment of taxes was also determined in City of Rochester vs. Bloss, 185, N. Y., 42. As the court in said decision clearly indicated, (page 52), taxes being mere statutory impositions do not bear interest at common law, nor do statutes providing for interest on debts, contracts and judgments apply to taxes. They do not draw interest as do sums of money owned upon contract but only if it is expressly given. The amount to be paid for the delinquency of a taxpayer to compensate the State for losses sustained through such delinquency must therefore be prescribed by the Legislature.

This statutory charge akin to that interest charge is prescribed in respect to the taxes, allowed in this case by Section 219c of the Tax Law, which prescribes the rate of one per cent per month in addition to ten per cent of the amount of the tax.

In United States vs. Guest, 143 Fed., Rep. 456, the Circuit Court of Appeals for the Fourth Circuit held that the provisions of the United States

statutes providing for the collection of delinquent internal revenue taxes with the penalty of five per cent per month, thereon and interest at the rate of five per cent per month, that such interest was not a penalty but was recoverable as interest, there being a five per cent penalty specifically prescribed on the amount of the tax.

In the case of Marshall vs. The People, 254 U. S., 380, The United States Supreme Court affirmed the right of the State to recover in full the amount of taxes due from a corporation in bankruptcy, which embraced within the claim all that the Legislature of the State prescribed should be a part of the tax obligation. This sovereign prerogative to receive in full the moneys required for the public revenue has been at all times recognized in the administration of the Bankruptcy Law of the United States. In fact, Section 64a of the Bankruptcy Act in express words directs taxes due to a State to be paid in advance of the payment of dividends to creditors without reference as to whether such taxes are liens upon the property of the bankrupt. Bankruptcy cannot therefore operate to divest the State of a right which it could have enforced through its revenue officers by the superior power of distress but for the fact that the property assets of its debtor had passed into custody of a court whose duty it was in the administration and distribution of those assets to respect

that paramount right upon the untrammelled exercise of which depends the power to protect the very fund being distributed. (American Bonding Company vs. Reynolds, 203 Fed. Rep., 356; Pennsylvania Steel Co., vs. New York City Railways Co., 193 Fed. Rep. 721; Greeley vs. Provident Savings Bank, 98 Mo., 458).

It is in the application of this principle that the courts in the decisions *in re* Kallak 147 Fed. Rep., 276; *In re* G. L. Schuyler & Company, 21 A. B. R., 428; *In re* Scheidt & Brothers, 23 A. B. R. 778, and *In re* Ramirez-Quinones, 39 A. B. R., 320, determined that the statutory execution for delinquency in payment of a tax due to the State became a part of the tax itself and was recoverable in connection therewith.

In re Kallak, *supra*, Amidon, District Judge, stated page 278:

> "So strongly have these considerations appealed to the courts, that the estates of bankrupts, even while in *custodia legis*, have been held subject to taxation by the State and its subordinate agencies."

It was held that if estates may be taxed under such circumstances, no sound reason can be advanced why revenue laws fixing the penalties with full effect in the case of taxes legally levied and assessed prior to the adjudication.

So also *In re* Scheidt & Brothers, *supra*, Sater, District Judge, gives a sound and logical reason for the principle as follows:

> "Its allowance is intended to cover interest until the delinquent taxes are put into judgment (Wheeling & Lake Erie R. R. vs. Wolfe, 13 Ohio Cir. Court Rep., 374), or are paid voluntarily or are collected by special effort by the treasurer in person or by his agent—in some manner other than by process of law. The penalty being treated as interest is collectible as part of the tax itself. (27 Amer. & English Encyc. of Law, 777, 778, 779). Under Section 64 of the Bankruptcy Act, the referee should have directed payment of both the taxes and penalty."

The decision in Ashland, Emory & Corundom, 229 Fed. Rep., 829, which the Circuit Court of Appeals followed, is not alone opposed to the weight of authority but unsound in principle. In allowing the interest at the rate of six percent per annum the Court disregards the well established common law principle that tax obligations bear no interest unless prescribed by the Legislature. In treating the penalty for non-payment of the tax in the same manner as a penalty incurred for the violation of a criminal statute the Court disregards the well established principle that the Legislature has the right to prescribe an exaction for non-payment of a tax which exaction, unlike the penalty for the commission of a crime, becomes a part of the tax obligation itself similar to ordinary interest on a debt.

The instant case furnishes the additional reason that under the decisions of the Courts of the State of New York, to which reference has been made in this brief, the Courts of the claimant State have determined that the penalty or exaction in question was a legislative imposition of interest, which it was justified to pass as such and which when accrued, became part of the tax obligation and was collectible through the same procedure as the tax itself. The statutory interest, as did the tax, became a lien upon the real and personal property of the debtor. This lien must be recognized by this court to the same extent as the original tax lien. Through the Circuit Court of Appeals, Second Circuit, following the decision quoted, a precedent has been created in this Circuit contrary to principle and authority, and one calling for a final review by this court.

Not alone is the State of New York vitally interested in the proper determination of the question involved, also the National Government in a similar construction of the Federal statute as considered in Matter of Menist, *supra*. In like manner as the first question involved in the instant case, the question of interest is one that will arise in all bankruptcy proceedings in which the bankrupt is a corporation, and it is as equally necessary to have this question finally determined.

It is therefore respectfully submitted that this case, both from the standpoint of importance, the

necessity of finality of determination and the elimination of conflicting Federal decisions, requires the exercise of the discretion of this court in granting the certiorari prayed for. The petition of the People of the State of New York should be allowed and the application for a Writ of Certiorari granted as prayed for therein.

Respectfully submitted,

CARL SHERMAN,
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By:
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C. T. DAWES,
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49 Chambers Street,
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Supreme Court of the United States,

OCTOBER TERM, 1922.

No. .

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioner,

AGAINST

LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS CO., INC.,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO APPLICATION FOR WRIT OF CERTIORARI.

POINT I.

The equities of the situation, and the plain language of the New York Statute which imposes the Franchise Tax, require that the tax be apportioned. Petitioner's remedy should be obtained by legislation.

The statute imposing the tax in question is Section 209 of the New York Tax Law, which so far as material, reads as follows:

> "*Franchise tax on corporations based on net income.* For the privilege of exercising

> its franchise in this state in a corporate or organized capacity, every domestic manufacturing and every domestic mercantile corporation * * * shall annually pay in advance for the year beginning November 1st next preceding, an annual franchise tax, to be computed by the Tax Commission upon the basis of its net income for its fiscal or calendar year next preceding, as hereinafter provided, upon which income such corporation is required to pay a tax to the United States."

The State Tax Department of New York filed a claim for a franchise tax for the year ending October 31, 1921. The bankruptcy occurred on December 22, 1920. It was claimed, therefore, by the Trustee in Bankruptcy that the bankrupt ceased to exercise its franchise on December 22, 1920, and that the tax being an annual tax for the privilege of exercising the franchise for a year, and it having been exercised but for about two (2) months, that the tax should be apportioned. The District Judge and the Circuit Court of Appeals sustained this contention.

The controversy, therefore, turns entirely upon the language of the statute imposing the tax. The instant case is the first one which squarely presented the necessity for a strict construction of § 209.

The Trustee contends that the above quoted language of the Tax Law makes it clear that the tax is apportionable, it being a tax for the privilege of exercising a corporate franchise *for a year,* and that the tax is imposed annually for such exercise of the franchise *for the year beginning November 1st of each year;* that the basis of the computation of the tax is the net income of the corporation in question for the fiscal or calendar year next

preceding; and that although the tax is denominated a franchise tax, its basis is therefore, an entire year's income of a corporation, and in reality it is an income tax (*People* vs. *Knapp,* 230 N. Y. 48).

Whether the tax is considered to be in reality an income tax, or whether the view taken be that the tax is as it is labelled, a franchise tax, is, however, immaterial in view of the controlling effect of the decision of the Court of Appeals of New York in the case of *People ex rel. Mutual Trust Company* vs. *Miller,* 177 N. Y. 51, which holds that the franchise tax is to be apportioned where the corporation in question did not exercise the franchise for the year for which the tax is imposed. In that case, the annual franchise tax had been imposed upon a trust company although it had only been in existence for six (6) days of the year in question. The company claimed that as it had carried on business but six days before the fiscal year expired the tax should be apportioned according to the period during which it exercised its corporate franchise. The company's contention was sustained by the Court of Appeals.

We quote from the decision of Vann, *J.,* at page 54, as follows:

> "The tax under consideration is not imposed upon property, but upon a privilege. *It is not imposed upon the privilege of becoming a corporation, for that would be an organization tax, payable but once for the entire period of corporate existence.* It is imposed 'for the privilege of exercising' the corporate franchise, and is measured by the value of the investment made and used in carrying on the corporate business. *It is an 'annual' tax, imposed 'annually', as the statute expressly provides, for the privilege of exercising, not of possessing, a*

corporate franchise. This privilege was used by the relator for only six days during the fiscal year in question. It could not exercise its franchise for the entire year, because the state did not bring it into existence until the year had nearly expired. *The consideration for the tax is the privilege of carrying on business, yet the relator, according to the requirement of the comptroller, was compelled to pay for a privilege that it did not have and could not exercise during the greater part of the period for which the tax was laid. It used the privilege for only six days, but it is taxed for using it 365 days, during 359 of which it did no business and enjoyed no privilege.* An annual tax is a tax reckoned by the year the same as annual rent or annual interest. An 'annual' tax imposed 'annually', means a tax that is imposed once a year, computed by the year. If a trust company does not commence business until six days before the fiscal year ends, OR IF IT CEASES TO DO BUSINESS SIX DAYS AFTER THE YEAR BEGINS, THE TAX FOR DOING BUSINESS BY THE YEAR REQUIRES APPORTIONMENT. *While the legislature did not so provide in express terms, it is a fair and reasonable implication from the words used that such was its intention.* When by Section 182 of the Tax Law it imposed an annual tax payable annually upon every corporation of a certain class, to be computed upon the basis of the amount of its capital stock 'employed within the state' during the year, it did not say expressly that the assessment should be determined by the *average* amount of capital so employed, but we held that this was what was necessarily meant. * * *"

This decision was followed by Judge Hough in his opinion in the Circuit Court of Appeals, which opinion is printed as an appendix to this brief.

Judge Augustus N. Hand in his decision in the

District Court holding that the tax should be apportioned, based his argument upon his understanding that the decisions of the New York Court of Appeals have rested upon whether the corporate franchises were actually exercised.

He says (fol. 149 of the printed record):

> "An actual exercise and not the mere right without the power to exercise seem to furnish the test laid down by the New York Court of Appeals."

The only difference between the statute as construed in the *Miller* case, *supra,* from the present statute, is that the tax is now, by amendment, payable annually in advance, but as Judge Hough says:

> "The requirement to pay annually in advance is directory only; the tax was the same tax on the day of petition filed that it was on the first of November. Undoubtedly the State may exact a price for beginning a year's business, or charge the same price for the privilege of transacting business one day or one year. *The question is not one of power, but of language,* and we are of the opinion that the changed language has not changed the nature of the tax."

It is further contended that the language of the statute under consideration points even more strongly to the apportionment doctrine than the statute under consideration in the *Miller* case, *supra,* for Section 209 provides not only that the corporation shall "annually pay" an "annual franchise tax", but in addition uses the words "for the year beginning November first, etc." In addition, it bases the tax upon the entire net income of the corporation for the previous fiscal or calendar year, whereas the tax in the *Miller* case, *supra,* above quoted from, was based upon the amount of the corporation's capital stock surplus and undivided profits.

It is now claimed, however, by the Attorney General, that the reasoning in the *Miller* case, *supra*, which was followed by the Circuit Court of Appeals, is no longer applicable by reason of the decision in *People ex rel. New York Central & Hudson River Railroad Co.* vs. *Gaus*, 200 N. Y. 328, although that point was not before the Court.

So far as that case is concerned it is submitted that it is not a controlling authority for the reason that it did not decide that the franchise tax under Section 209 was not apportionable. That case arose under Section 182 of the Tax Law, *and not under Section 209 which applies to mercantile and manufacturing corporations only.* The interpretation of Section 209 as to the exercise of the franchise was not involved in that case, nor any question as to the exercise of the franchise. Under Section 182 of the Tax Law the franchise tax is based upon the amount of the capital stock of the corporation employed during the preceding year within the state. The Court of Appeals held in *N. Y. C. R. R.* vs. *Gaus, supra* (and we submit that is the only thing decided by the case), that where the capital stock as it existed on November 1st, 1906, had been increased on the following January and remained at the increased amount until the end of the fiscal year, the State Comptroller properly assessed the stock on the basis of the whole outstanding stock at the end of the tax year.

The references to the *Miller* case, in the *Gaus* case, therefore, upon which petitioner so much relies, we submit have no bearing upon the matter decided in that case, and in no way weaken the force of the reasoning in the *Miller* case which the Circuit Court of Appeals followed.

The decision in the case at bar depends upon the

construction of the language of the statute imposing the tax.

> "A statute which levies a tax is to be construed most strongly against the Government and in favor of the citizen. The Government takes nothing except what is given by the clear import of the words used, and a well founded doubt as to the meaning of the Act defeats the tax." (*People ex rel. Mutual Trust Co.* vs. *Miller, supra.*)

Applying this principle, and reading the statute in the light of the decisions of the highest court of the State of New York interpreting similar language in taxing statutes, the conclusion follows that the apportionment of the tax was right and fully warranted by the language of the act. It is not for the court, to say that the price for exercising a corporate franchise shall be the same for one day or for one year.

Surely, the matter can be readily remedied by the legislature, if such be its intention, by amending the statute so as to provide against an apportionment of the tax.

POINT II.

The Court below properly held that a claim for interest at the rate of one per cent. per month in a bankruptcy proceeding is a penalty and should be disallowed.

Section 57-*j* of the Bankruptcy Act provides as follows:

> "Debts owing to the United States, a state, a county, a district, or a municipality as a

> penalty or forfeiture, shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transfer or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

The District Judge and the Circuit Court of Appeals held that inteerst on the tax should be allowed up to the date of payment, but that interest at the rate of one per cent. (1%) per month amounts to a penalty and must be disallowed, under Section 57-*j* of the Bankruptcy Act.

There has been some conflict of authority on this question, but we submit that the reasoning *in re Ashland, Emery & Corundum Co.*, 229 Fed. 829, which was followed by both the District Judge and the Circuit Court of Appeals, is sound in principle and a proper interpretation of the Bankruptcy Act.

In that case the Court said at page 831:

> "If the charge here in controversy is to be regarded as interest, the trustee ought to pay it. Penalties, however, stand upon a different footing. It cannot be said that a penalty imposed for failure to pay a tax, is part of the original tax, in the sense that interest is. By 'interest' is ordinarily understood a charge for the use of money or damages for the detention of it. A penalty, as applied to cases of this character, means a punishment imposed for failure to make the payment on time. Section 64-*a* contains no provision for the payment of penalties; and I do not think it can fairly be construed to include them, especially when, as here, the estate was in course of administration during the entire period when they accrued."

and again at page 832:

> "Assuming, however, that it is, it seems to me plain, and I accordingly find, that 1% a month exceeds what is fairly required to make good loss to the state for mere delay in the payment of the tax, and as to such excess is not interest, but constitutes a penalty imposed for failure to pay promptly. The actual damages sustained by the State of New Jersey from the delay are not obscure nor difficult to estimate. What the state lost was the use of the money. Its damages therefore are the commonest form known to the law, and the most certain of estimtaion. They are established by statute in New Jersey for individuals at 6% per annum."

The fact that the statute itself calls it interest would not be conclusive upon the Bankruptcy Court, which has the right and power as well as the duty, to examine and decide the question for itself.

In re Ashland, Emery & Corundum Co. (*supra*).

State of New Jersey vs. *Anderson*, 203 U. S. 483.

In disposing of this branch of the case the Circuit Court of Appeals did not express its views but refers to its decision filed the same day, *in re J. Menist Co.* As the decision is not yet reported we submit as an appendix to this brief the opinion of Judge Hough in the Circuit Court of Appeals in the *Menist* case on this question.

That case holds that a claim in a bankruptcy proceeding for interest at the rate of one per cent. (1%) per month under a taxing statute, in the

absence of proof of pecuniary loss by the state or municipality, is a penalty within the language of Section 57-*j* of the Bankruptcy Act, and cannot be allowed.

POINT III.

The application for the writ of certiorari should be denied, with costs.

Respectfully submitted,

HENRY B. SINGER,
Of Counsel for Respondent.

Appendix.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

Before:

Hon. CHARLES M. HOUGH,
Hon. MARTIN T. MANTON,
Hon. JULIUS M. MAYER,
Circuit Judges.

IN THE MATTER

OF

AJAX DRESS CO., INC., bankrupt.

STATE OF NEW YORK and STATE TAX DEPARTMENT,
Appellants.

APPEAL FROM AN ORDER IN BANKRUPTCY ENTERED IN THE DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

The petition against the above named bankrupt was filed 22d December, 1920, and adjudication duly followed.

Against the estate the State Tax Department filed a claim for a "franchise tax, for period ending October 31, 1921"; the amount claimed being

For tax	$448.34
"Penal interest, etc.".....	87.03
Total	$535.37

The bankrupt was a manufacturing or mercantile corporation of the State of New York. The tax claimed arises under Section 209 of the Tax Law of New York, which, so far as material, reads thus:

> *"Franchise tax on corporations based on net income.*
>
> For the privilege of exercising its franchise in this State in a corporate or organized capacity, every domestic manufacturing and every domestic mercantile corporation * * * shall annually *pay in advance for the year beginning November 1st next preceding,* an annual franchise tax, etc."

The bankrupt ceased actual business on the day of petition filed, so that it exercised its franchise something less than two months out of the twelve months for which the tax was levied and leviable.

The Court below apportioned the tax and allowed of the claim a fraction which represented the portion of the year during which the bankrupt exercised its franchise.

As Ajax Co. had not complied with the statute and paid the tax, the State claimed under Section 219-*c* of said tax law

> "In addition to the amount of said tax, ten per centum of such amount plus one per centum for each month the tax remained unpaid."

The Court below denied this claim, treating it as a penalty, but allowed six per cent. interest on the apportioned tax to the day of the date of actual payment by the Trustee.

From the order embodying this decision the present appeal was taken.

ROBERT P. BEYER, Deputy Attorney General of the State of New York, for appellants; HENRY B. SINGER for the Trustee in bankruptcy.

HOUGH, *C. J.*

The question whether that which the State calls a tax is a tax and a proper tax, produces a federal question under the Bankruptcy Act (*New Jersey* vs. *Anderson,* 203 U. S. 483). Yet under familiar rulings, the construction of a state statute and the definition of its terms are matters on which we should ordinarily follow the authority of the highest state court.

Therefore we regard the first branch of this case as raising only the question whether it is or is not governed by *People* vs. *Mutual Trust Co.,* 177 N. Y. 51.

In that case the operative words of the statute were that the said Trust Company, being incorporated under the law of New York,—

> "shall pay to the State annually for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity an annual tax", etc.

The Trust Company organized on June 6, 1901, and opened for business on June 24th. A tax was levied for the year ending June 30, 1901, and the state demanded that for the privilege of transacting business for six days it should pay the same tax that it would have paid for doing business three hundred and sixty-five days.

Vann, *J.,* pointed out that the demand was for "an annual tax imposed annually", and for the privilege of "*exercising* not of *possessing* a corporate franchise". Further that it could not "exer-

cise its franchise for the entire year because the state did not bring it into existence until the year had nearly expired". The consideration for the tax was the *privilege* of carrying on business; yet the state was endeavoring to require the relator to pay for a privilege that it "could not exercise during the greater part of the period for which the tax was laid". Further, said the Court, an annual tax imposed annually meant a tax "imposed once a year computed by the year"; and the tax was "measured by an annual business done".

It was further pointed out that in *People* vs. *Spring Valley Co.*, 92 N. Y. 383, there (and here) relied upon by the state,—the question of apportionment had been raised neither by the pleadings nor at trial, and although sought to be raised in the court of last resort, was not considered for obvious reasons.

The question now at bar is whether, since the present statute requires a corporation to pay the tax "annually in advance", the reasons for the Mutual Trust Co. decision have been swept away by changing the language of the statute.

Every reason advanced by the court in the *Mutual* decision is applicable here. The requirement to pay "annually in advance" is directory only; the tax was the same tax on the day of petition filed that it was on the first of November. Undoubtedly the state may exact a price for beginning a year's business, or charge the same price for the privilege of transacting business one day or one year. The question is not one of power, but of language, and we are of opinion that the changed language has not changed the nature of the tax. Comparing the *Mutual* case with this;—both taxes are franchise taxes; both are measured

by business or the means of doing business; both are for the exercise of a franchise; neither is for the possession of a franchise, nor is either a price exacted on giving a franchise; in both the contemplation of law is that the franchise shall cover the business done thereunder for a year.

For these reasons we follow the *Mutual* decision in holding that the tax was properly apportioned below. The case of *New York Terminal Co.* vs. *Gaus,* 204 N. Y. 512, is not applicable; there a receiver had exercised the taxable franchise, and was held taxable thereon and therefor. Nothing of the sort is here suggested.

The inability of the Mutual Company to exercise its franchise for the yearly period was caused by non-existence; the inability of Ajax Co. to do the same is caused by deprivation through bankruptcy of all means of exercising the privilege; the business and logical result is the same. The somewhat sardonic suggestion that had Ajax Co. paid the tax and gone out of business or into bankruptcy in a few days, there would have been some difficulty in getting a rebate from the State, is not persuasive in law, though quite true in practice.

So far as the state's second demand, for penalties and interest is concerned, the matter is covered by our opinion in *Re Menist,* filed today. That decision relates to a claim for interest at one per cent. per month made by the United States in respect of its demand for lawful and unpaid taxes; but whatever is there said is applicable with equal force to the demand of the State of New York, not only for one per cent. a month, but for what is confessedly a penalty and called by that name.

Order affirmed with costs.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

Before:

HON. HENRY WADE ROGERS,
HON. CHARLES MERRILL HOUGH,
HON. JULIUS M. MAYER,
Circuit Judges.

IN THE MATTER
OF
J. MENIST CO., INC., bankrupt.
UNITED STATES OF AMERICA,
Appellant.

APPEAL FROM AN ORDER IN BANKRUPTCY ENTERED IN THE DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

The petition in this matter was filed 20th March, 1920.

On 28th November, 1919, the United States had assessed on Menist's income for 1917 an additional tax of $2,421.75, and required the corporation to pay the same on December 11, 1919. No payment was made.

On 5th May, 1921, the United States filed a claim in this proceeding for the said tax plus five per cent. penalty and one per cent. interest per month until paid.

That the tax was duly levied and is correct in amount are matters not in controversy.

The statutory justification asserted for the demand of interest and penalties is Act of October 3, 1917 (40 Stat. 300, Sec. 212) making Sec. 14(*a*) of the Act of September 8, 1916 (39 Stat. 756) applicable to taxes under the 1917 Act.

By these statutes it is provided that

> "* * * to any sum or sums due and unpaid after the fifteenth day of June of any year, or after one hundred and five days from the date from which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the Collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due."

At the hearing below the United States withdrew its claim for the penalty of five per centum, but insisted upon the demand for one per cent. per month under the guise of lawful interest.

The lower Court held that so-called interest at the rate of one per cent. a month amounted to a penalty, and therefore allowed the tax with interest at six per cent. to be computed to the day of the date of payment by the trustee.

There appears to be an error in the transcript as to the time when interest should begin. It has not been insisted upon in argument and may be corrected by agreement.

From the order embodying this decision the present appeal was taken.

VICTOR HOUSE, Assistant U. S. Attorney, for appellant;

E. FICHANDLER for the Trustee in Bankruptcy.

HOUGH, *C. J.*

The fundamental proposition thought to justify this appeal is that a tax is not a debt. This is usually true; taxes are not treated as debts, because the latter are obligations founded on contract, while taxes are imposts levied by government and operating *in invitum* (*Meriwether* vs. *Garrett,* 102 U. S. 472, at 513-514).

But we are here concerned only with the bankruptcy statute, and a tax whether due to the nation, to a state or any other lawful taxing power, is a species of debt under that Act. This is because it is called a debt by the statutory caption of Sec. 64, which is the law invoked, and properly invoked, by the Government in pursuing its present demand (30 Stat., p. 563). Further, this Court has so decided *In re Sherwoods,* 210 Fed. 754 (758), and the point is elaborately and well treated in *Kaw, etc.* vs. *Schull,* 230 Fed. 587.

A tax being then a preferred debt; neither interest nor any other derivative or appended claim can rise higher than the tax debt which gives it birth and being; and it is provided in respect of all debts "owing to the United States, a state, a county, etc." as a *penalty,*—shall not be allowed except for the amount of the pecuniary loss sustained in the proceeding out of which the penalty arose (Sec. 57*j*).

It is a matter almost too plain to require citation, that an exaction may be a penalty without being called by that name (*Fontenot* vs. *Accardo,*

278 Fed. 871, at 874). The question is often one of degree, for no one would doubt that if the statutory rate for withholding a tax was one per cent. a day, the requirement would be treated as a penalty.

Subject to statutory limitation, the rate of interest or, what is the same thing, compensation for the use of money, is ordinarily fixed by agreement of parties. But in tax matters there is no such agreement; one party commands and the other must obey, and again subject to constitutional limitations the commanding party may impose any terms of payment that it pleases, and it makes no difference whether the price of delayed obedience is called interest or penalty or fine or additional tax; every increase over the amount that satisfies the tax if paid the moment it is levied, is merely an additional exercise of the power of the taxing authority.

Since in bankruptcy (and we are solely concerned with bankruptcy) the power of ascertaining the amount or legality of any tax is vested in the Court (Sec. 64*a*) and penalties are not to be allowed except for the amount of pecuniary loss sustained by the delayed payment, the only question here is whether an exaction of one per cent. a month as the price of delay amounts to a penalty (As to nature of interest generally see *Agency, etc., Co.* vs. *American Co.*, 258 Fed. 363, at 372).

On the point at bar we are in accord with *Re Ashland, etc., Co.*, 229 Fed. 829, and hold that, there being no evidence of any injury or damage to the Government by the withholding of this tax except that which flows from the non-payment of a just debt, anything in excess of the legal rate of interest is to be treated as a penalty and not allowed.

The point seems not to have been argued in *Re Kallak,* 147 Fed. 276, *In re Scheidt,* 177 Fed. 599, or *In re Quinones,* 39 A. B. R. 320; but in the implications of these cases we cannot concur. As the question here arises under the Bankruptcy Act.—*United States* vs. *Guest,* 143 Fed. 456, does not apply; there being no reason why a penalty, by whatever name called, may not be, enforced against an individual,—if properly expressed in agreement or statute.

The question remains whether a tax demand duly proved should continue to draw interest at the legal rate after the filing of petition for adjudication. The general rule is of course that interest stops with petition filed (*Sexton* vs. *Dreyfus,* 219 U. S. 339), but a tax debt due to any of the taxing authorities enumerated in Section 64*a* is not only a highly preferred debt, but the section contains specific directions that the trustee shall pay "all taxes legally due and owing". That means legally due and owing in accordance with the provisions of the bankruptcy act, and under that statute Section 57-*j* requires penalties due to the United States, or a State, etc., to be allowed to the extent of the pecuniary loss suffered. The loss continues as much after petition filed, as before.

We agree with the Court below that these directions cannot be fulfilled except by an order on the trustee to pay the tax with lawful interest down to the date of actual payment.

Order affirmed.

Supreme Court of the United States

OCTOBER TERM, 1923.

No. 352.

THE PEOPLE OF THE STATE OF NEW YORK,
Appellant,

against

LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS CO., INC.,
Appellee.

BRIEF FOR APPELLANT

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Supreme Court of the United States

OCTOBER TERM, 1923.

No. 352

THE PEOPLE OF THE STATE OF NEW YORK,

Appellant,

against

LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS CO., INC.,

Appellee.

CERTIORARI FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

SUPREME COURT
OF THE UNITED STATES

THE PEOPLE OF THE STATE OF NEW YORK,
Appellant,
against
LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS CO., INC.,
Respondent.

APPELLANT'S BRIEF.

Statement of the Case.

On or about December 22, 1920, a petition in bankruptcy was filed in the United States District Court for the Southern District of New York, against the Ajax Dress Co., Inc., a corporation duly organized and existing under and by virtue of the laws of the State of New York. The said Ajax Dress Co., Inc., was duly adjudicated a bankrupt, and the matter of the bankruptcy proceeding was referred to John J. Townsend, as referee in bankruptcy. The respondent, Louis Jersawit, was duly selected trustee of said bankrupt.

On or about April 3, 1922, the appellant, The People of the State of New York filed with the referee in bankruptcy a claim for franchise taxes,

based on the income of the bankrupt for the calendar year, 1919 at four and one-half per cent, said tax being for the privilege of doing business for the year commencing November 1, 1920 and ending October 31, 1921, as follows:

STATE FRANCHISE TAX.

On Business Corporations under Article 9-A of the Tax Law as amended:

For period ending October 31, 1921:

Tax based on income 4½%	$448.34
Penal Interest, etc.	87.03
Total	$535.37

Section 209 of the Tax Law of the State of New York, under which said tax arose, provides as follows:

> "Sec. 209. Franchise tax on corporations based on net income. For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section, shall annually pay in advance for the year beginning November first, next succeeding the first day of July, in each and every year an annual franchise tax, to be computed by the tax commission, upon the basis of its entire net income for its fiscal or the calendar year next preceding, as hereinafter provided, which entire net income is presumably the

same as the entire net income upon which such corporation is required to pay a tax to the United States."

The rate of the tax is fixed by Section 215 of the Tax Law of the State of New York, providing that the tax shall be at the rate of four and one-half per centum of the entire net income of the corporation or the portion thereof taxable within the state.

Section 219-c of the tax law of the State of New York, provides that the tax shall be paid to the State Tax Commission on or before the first day of January of each year, and that, if the tax be not so paid

> "the corporation liable for such tax shall pay to the State Tax Commission, in addition to the amount of such tax, ten per centum of such amount, plus one per centum for each month the tax remains unpaid.
>
> Each such tax or additional tax shall be a lien upon and binding upon the real and personal property of the corporation liable to pay the same until the same is paid in full."

At the first meeting of the creditors of the Ajax Dress Co., Inc., bankrupt, held before the Referee at his office on the 12th day of April, 1922, the respondent, Louis Jersawit, as Trustee in Bankruptcy, made objection to the claim of the appellant, The People of the State of New York, as filed, and contended:

1. That there shall be an apportionment of the state franchise tax for the year be-

ginning November 1, 1920, as follows: viz., that the tax claim should be allowed only for that portion of the year which elapsed between the beginning of the tax year, November 1, 1920 and the date of the filing of the petition in bankruptcy, December 22, 1920, and that the entire amount of the tax claim should thus be reduced proportionately as the elapsed period bore to the entire year.

2. That the statutory interest should not be allowed.

The referee held, in disposing of the objections that the tax assessed against the bankrupt, being under statute directed to be paid in advance, based upon income earned in the state during the preceding year was not apportionable and must be paid in full; and that under the law as established *in re.* Kallak, 17 A. B. R., 415, 147 Fed. Rep. 276; *In re.* G. L. Schuyler & Co., 21 A. B. R., 428; *Re.* Scheidt & Brother, 23 A. B. R., 778, 187 Fed. Rep., 599; *Re.* Ramirez-Quinones, 29 A. B. R., 323, U. S. vs. Guest, 143 Fed. Rep., 456, the statutory exaction made by the statute for non-payment of the tax should be construed as prescribing interest and not as imposing a penalty. The referee refused to follow a decision to the contrary rendered *in re.* Ashland. Emery & Corundum Co., 36 A. B. R., 194, 229 Fed. Rep. 829. A referee's order was accordingly entered on November 2, 1922, ordering that the claim of the State of New York filed on the 3rd day of April, 1922, for a franchise tax for the period ending October 31, 1921 be allowed in the sum of

$448.34 for the principal of said tax, and interest upon said principal at the rate of 1% per month from January 1, 1921 to the date of the payment of said tax in addition to the said principal sum, and that the said claim be allowed as one entitled to priority of payment.

Thereafter, the trustee in bankruptcy duly filed a petition to review the said order of the referee and obtained a certificate of the referee on said petition under date of November 23, 1922, certifying the determination made by the referee as stated, and the papers and proceedings upon which the said determination was based. A hearing upon said petition and certificate was duly held by the United States District Court for the Southern District of New York, Justice Augustus N. Hand, United States District Judge, presiding, on the 29th day of November, 1922. United States District Judge, Augustus N. Hand, rendered an opinion, holding that the tax due and owing to the People of the State of New York should be apportioned as prayed for by the trustee in bankruptcy, and, following the decision *in re.* Ashland, Emery & Corundum Co., 36 A. B. R., 194, 229 Fed. Rep. 829 and refusing to follow the other decisions mentioned in the opinions of the referee, and further holding that the interest to be allowed to the appellant, The People of the State of New York, on its tax claim as apportioned, be at the rate of 6% per annum to the date of pay-

ment. An order of the District Court for the Southern District of New York reversing the referee's order in the manner and form stated was duly entered on the 20th day of December, 1922.

The appellant thereupon prosecuted an appeal to the United States Circuit Court of Appeals for the Second Circuit, as well as presenting to said court a petition to revise the said order of the United States District Court for the Southern District of New York on seven assignments of error duly filed which related to the action of the District Court of the United States for the Southern District of New York in apportioning its tax claim as filed in the manner as stated and in reducing the interest rate allowed by the referee to 6% per annum. The said appeal was duly argued in said Circuit Court of Appeals for the Second Circuit during the April term of said court, and on April 23, 1923, a decision was duly entered, affirming the decree of the District Court of the United States for the Southern District of New York.

Thereupon, the appellant, The People of the State of New York, duly filed its petition for a writ of certiorari with this court. The writ of certiorari applied for was granted by this court and the case is now before this court for determination on the merits.

Specifications of Error Relied Upon.

The appellant contends:

1. That the determination made by the United States Circuit Court of Appeals for the Second Circuit is contrary to and subversive of the expressed language of the statute of the State of New York, relating to taxation and the decisions of the courts of the State of New York in the interpretation of such statute.

2. That the decision of the Circuit Court of Appeals for the Second Circuit was based upon a misapprehension of what the courts of the State of New York have decided respecting the questions at issue, and misconstrued the meaning and intent of Section 209 of the Tax Law of the State of New York.

3. That the decision of the Circuit Court of Appeals of the United States for the Second Circuit unjustly operates to take away the effect of the statutes of the State of New York, relating to taxation, erroneously limits the scope of such statutes and seriously affects the taxing power of the State of New York.

4. That the decision of the United States Circuit Court of Appeals for the Second Circuit is erroneous in determining that the franchise tax assessed against the bankrupt herein should be

apportioned, and that the interest on such tax should be limited to the rate of six per cent per annum instead of the rate provided for by statute, and that the law to be now determined in this case is correctly stated in the opinion and order of the referee in bankruptcy of the bankrupt, Ajax Dress Co., Inc.

5. That error was committed in affirming the order of the United States District Court for the Southern District of New York in reversing the order of the referee dated November 2, 1922, and apportioning the tax claim filed by the appellant, The People of the State of New York.

6. That error was committed by the Circuit Court of Appeals for the Second Circuit, in affirming the order of the United States District Court for the Southern District of New York, and in reversing the order of the referee, so far as the said order provided that the tax should be apportioned for the period of the taxable year to the period of the taxable year that elapsed prior to the filing of the petition in bankruptcy.

7. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York, in holding that the franchise tax, claim for which was filed with the referee in bankruptcy was one for the actual exercise of a franchise and not for the privilege of exercising a franchise.

8. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York in finding and deciding that this tax should be apportioned notwithstanding the fact that the statute law of the State of New York made the tax payable in advance.

9. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York in that said order, and the opinion upon which it was based failed to find that the tax, claim for which was filed, was based upon income for the calendar year 1919, as shown in the return made by the Ajax Dress Co., Inc., to the United States Internal Revenue and was at the rate of four and one-half per cent thereof and was audited and stated by the State Tax Department of the State of New York for the privilege of doing business for the year commencing November 1, 1920, and ending October 31st, 1921, and was payable in advance by the terms of the New York statute.

10. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York in that said order failed to recognize the lien created by the statute law of the State of New York for said taxes from

the time that same was payable until it was paid in full.

11. The United States Circuit Court of Appeals for the Second Circuit erred in affirming the order of the United States District Court for the Southern District of New York in reducing interest upon the said claim from one per cent a month to six per cent per annum, notwithstanding the fact that the statute law of the State of New York provides for interest at the rate of one per cent per month.

POINT I.

The Franchise Tax assessed against the Ajax Dress Co., Inc., pursuant to Section 209 of the Tax Law of the State of New York, being payable in advance November 1, 1920, based upon the income that the corporation earned for the preceding calendar year was one for the privilege of continuing to exercise the corporate franchise and should not be apportioned in amount to the period prior to December 22, 1920, when said corporation was adjudicated a bankrupt.

The protection which should be accorded to the state in the conservation of its taxing powers has been already announced by this court. In Marshall vs. The People, 254 U. S., 380, this court permitted a certiorari to issue to the United States

Circuit Court of Appeals for the Second Circuit, so that the matter of state priority in the collection of tax obligations could be finally determined, and this court in holding, in this decision, that the state is entitled to be paid the amount of tax obligations due it as a priority creditor because of its sovereign capacity, has fully recognized the principle that is of vital importance to the stability of government, that the state be protected to the utmost in securing that revenue upon which the ability to govern depends. This same principle is controlling in the decision of this court in the case of New Jersey vs. Anderson, 203 U. S., 483, construing the tax statute of the State of New Jersey. This court held in said authority that the state creating a corporation may fix the terms of its existence, and provide that for the continued exercise of its franchise it must yearly pay the state certain sums fixed by the amount of its outstanding stock. In that case, the franchise tax due by the corporation was payable on January 1st of each year for the ensuing year. The corporation was adjudicated a bankrupt on April 23, 1903, a little over four months after the tax was payable. This court held that the tax must be paid in full, even though no specific lien against the property of the corporation attached when the corporation went into bankruptcy. Mr. Justice Day of this court stated, page 494:

> "The amount claimed for the year 1903, it is insisted had not accrued at the time the adjudication in bankruptcy, which was on April 23, 1903, the return being made on

May 2, 1903 and the assessment was not made until July 1, 1903; but the actual return required to be made to the board on or before the first Tuesday in May is upon the basis of the capital stock issued and outstanding, as of January, preceding the making of the return. The Bankruptcy Act requires the payment of all tax legally due and owing. We think the tax thus assessed upon that basis was legally due and owing, although not collectable until after the adjudication."

The New York statute is similar to that of the New Jersey statute as to the specific income of the corporation upon which the return to the state is to be measured. The franchise tax levied by the State of New York is based upon a percentage of the income earned in the state for a preceding year to November 1st of each year. The New York statute prescribes clearly that the tax thus assessed upon that basis legally due and owing on November 1st, and grace is given to the corporation affected to pay the tax without penalty on or before January 1st succeeding. There is nothing in the statute relative to any apportionment of the tax thus levied, and the plain reading in the language of the statute negatives any possibility of any such construction thereof.

The Circuit Court of Appeals for the Second Circuit, on this question, relied upon the case of People vs. Mutual Trust Co., 177 N. Y. 51, which construed present Section 188 of the tax law of the State of New York relating to franchise tax on trust companies, and which provides that

"Every Trust Company incorporated, organized or formed under, by or pursuant to a law of this state * * * shall pay to the State annually for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity, an annual tax which shall be equal to one per centum on the amount of its capital stock, surplus, and undivided profits."

By relying upon this early Mutual Trust Company case the Circuit Court of Appeals has misunderstood the present state of law in New York. The New York Court of Appeals has directly shown the inapplicability of the Mutual Trust Company case to the present system of taxation, and it has done so by a full discussion of the Mutual Trust Company case. We are referring to the later decision in People *ex rel.* N. Y. C. & H. R. R. R. Co. vs. Gaus, 200 N. Y. 328, a decision not commented upon by the Circuit Court of Appeals or by Judge Hand. In the New York Central case the tax was payable in advance, while in the Mutual Trust Company case the tax was payable for the past year. Speaking of its determination in the first case and showing the difference between the two taxes the Court said, at page 330:

> "this court held in *People ex rel. Mutual Trust Co. v. Miller* (177 N. Y. 51), where the relator began business a few days before the end of the tax year, that it was only the average outstanding stock during the year which was to be taken as the basis of the tax. In that case we treated the franchise tax as an

exaction *for the privilege afforded to the corporation for the past year. After our decision, however, the legislature amended section 182 of the Tax Law so as to provide that the tax should be paid in advance. The amendment changed the character of the tax as to corporations embraced within that section, from a payment for past privileges already enjoyed to a payment for privilege to be enjoyed in the following year.* Trust Companies are not taxed under section 182, but under section 187a. While the tax in each case is a franchise tax and so regarded in law, there is a very marked distinction between the two. The tax imposed on corporations generally under section 182 amounts to 1½ mills on the capital stock of a corporation paying 6% dividends, and its payment does not exempt the corporation from local or property taxes. On the other hand, the tax on a trust company is 1%, and relieves the company from all other taxation. *After the amendment of section 182, the grounds on which we placed our decision in the Mutual Trust Co. case became no longer applicable to corporations taxed under that section.* But that amendment in no way affected corporations taxed under section 187a, where a very different tax is imposed. For this reason our decision in the Mutual Trust Co. case, so far as it related to trust companies, remained unaffected. Subsequently there arose the case of People *ex rel.* Lincoln Trust Co. v. Glynn (132 App. Div. 546), the decision in which was affirmed by this court on the opinion below in 198 N. Y. 501. In that case it was held that the method of taxation of trust companies had not been altered by the change in the law. *The distinction between the two cases was clearly pointed out* in the opinion of the learned Appellate Division."

All of the foregoing was unnoticed by the Circuit Court and by Judge Hand, and it is doubtful whether the lower courts appreciated the existence of the opinion in the New York Central case.

The District Court refers also in its opinion to People *ex rel.* Lehigh and New York Railroad Co. vs. Sohmer, 217 N. Y. 443, where Section 182 of the Tax Law as it then read was under review. Section 182 of the Tax Law considered by the court in said case, reads radically different from Section 209 of the Tax Law in the instant case, in that the words in section 182 "for the privilege of doing business or exercising its corporate franchise in this State" were at the time the Lehigh case was before the courts qualified by the repetition of the words "doing business in this State." In other words, both a domestic corporation as well as a foreign corporation had at that time *to be doing business* before a tax accrued. After the decision in 217 N. Y. 443, and because of it the legislature amended Section 182 of the tax law, eliminating the words "doing business" when applicable to domestic corporations. The legislature has therefore given clear expression of its intent, that it changed the ruling as made by the Court of Appeals in 217 N. Y. 443, and that the doing of business in the case of a domestic corporation was not to be considered as affecting the tax accruing under section 182 of the tax law. In like manner, the legislature has provided, in Section 209 of the tax law, that the doing of business in this state had no relation

to domestic corporations such as the bankrupt herein or as to its privilege of exercising its franchise in this State in a corporate or organized capacity. The reason for the tax and the actual privilege taxed are stated differently for a domestic corporation and for a foreign corporation, the tax for a domestic corporation is for the privilege of "exercising its franchise in this state in a corporate or organized capacity," and the tax for a foreign corporation is for the privilege of "doing business in this state":

> "Sec. 209. *Franchise tax on corporations based on net income.* For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section shall annually pay in advance for the year beginning November first next succeeding the first day of July in each and every year an annual franchise tax, to be computed by the tax commission upon the basis of its entire net income for its fiscal or the calendar year next preceding, as herein after provided, which entire net income is presumably the same as the entire net income upon which such corporation is required to pay a tax to the United States, * * *."

The tax is directed to be paid on the basis of income earned during the preceding year and was expressly directed to be paid in advance of the ensuing calendar year. Neither the basis upon which the tax was calculated nor the time of payment has any reference to business to be trans

acted thereafter. It is akin to a license fee or income tax based upon benefits theretofore derived in the State as a condition for permission to continue to exercise such privilege or franchise for a succeeding year. It was a measure of valuation adopted by the legislature so that the franchise could be uninterruptedly exercised and its value at all times definitely determined (People *ex rel.* Barcalo Mfg. Co. vs. Knapp, 227 N. Y. 64).

This question was construed in New York Terminal Co. vs. Gaus, 204 N. Y., 512, where property of a corporation was operated by a receiver during which period of operation franchise taxes for the privilege of doing business or exercising corporate franchises were levied by the State. The property of the corporation was sold by the receiver during the tax period under foreclosure. It was held that the lien of the tax continued in its entirety.

Likewise in the case of Marshall, 254 U. S., 380, there was no suggestion of an apportionment. In that case the District Court allowed the full amount of the franchise tax without apportionment.

The case of New York Terminal Co. vs. Gaus was followed by this Court in Penn. Steel Co. vs. The New York City Railway Co., 198 Fed. Rep., 768. Judge Ward, page 771, stated:

> "These taxes were made a lien by Section 197 of the Tax Law, and although we have

> held under the similar Federal Law, (Chapter 6, Laws of 1909), that they are not payable by receivers, the Court of Appeals of the State of New York has held that a similar tax under Section 182 of the New York Tax Law is payable by the receivers and remains a lien on the premises after sale and foreclosure, New York Terminal Co. vs. Gaus, 204 N. Y., 512. We feel obliged to follow this decision and to hold that the purchaser take the premises subject to the tax."

The real purpose of the franchise tax enacted by Section 209 of the Tax Law further appears from the decision in People *ex rel.* Cornell Steamboat Company vs. Sohmer, 206 N. Y., 651, in which case Cullen, J., stated:

> "I doubt whether in the true sense of the term it is to be considered a tax, but should not rather be deemed a compensation, exacted for the privilege which the State might refuse. If the parties beneficially interested in the appellant are dissatisfied with the price exacted by the State they may have the corporation dissolved and as individuals carry on the same business that is being done now without the cost of any such charge."

The laws of the various states, particularly that of the State of New York, furnish innumerable instances where a particular trade or calling or the performance of particular acts, is required to be licensed, and where one of the conditions of obtaining such license is the payment of a fee covering a particular license period. Various illustrations are found under the general business laws of the State of New York, relating to the

licensing of auctioneers, peddlers, junk-dealers, private detectives, warehousemen, employment agencies and moving picture exhibitions; under the general Highway Law, relating to the registration and licensing of motor vehicles; under the Charter of the City of New York, creating the license bureau of the City of New York, which has jurisdiction over various other forms of business activities. It is academic that where a license is granted upon payment of the legal fee covering a stated period that no refund of such license is permissible, even though the licensee does not avail himself of the privilege conferred for the entire license period.

(Hart vs. Beauregard, 22 L. A. Ann., 80.)

Other instances of non-apportionment of a debt payable in advance for a certain privilege conferred, is afforded by leases, which provide that rent for certain periods should be paid in advance. It has been determined by this court and other Federal courts, in bankruptcy that where such is the case the claim of the landlord can be proven for the amount of the stipulated rental payable in advance, even though the tenure of the term covered by said rent should have been interrupted by bankruptcy proceedings (*Re* Pittsburgh Drug Co., 164 Fed. Rep., 162; McCann vs. Evans, 185 Fed. Rep., 93; *Re* Sherwoods, 210 Fed. Rep., 754; *Re* Scruggs, 205 Fed. Rep. 673).

The tax due to the State of New York was due November 1, 1920. The payment thereof, made it

lawful for the corporation to continue to exercise its franchise for the ensuing year. It recognized the liability for the tax by taking advantage of the privilege conferred by the State in continuing to exercise its franchise after the tax had accrued. The State is not interested to what extent the privilege conferred is exercised. Any act done by the corporation under the privilege conferred makes it amenable to respond to a tax of this nature which, by statute, is expressly stated to be paid in advance. There is nothing in the statute relative to any apportionment of the tax thus levied. In the absence of any statutory direction, no apportionment can be decreed by the Court.

The inequitableness of apportioning or prorating a tax is pointed out in the case of Archibald McNeil & Sons Co. *et al.*, vs. Bay State St. Ry. Co., 282 Fed. 338. In that case the tax was based on the gross earnings for a complete year and the court says:

> "By the statute the computation of the tax is based on the return of the street railway company. In certain details, which might change from month to month, it has been definitely held by the Supreme Judicial Court that there could be no prorating or adjusting; that the intent of the statute was that the assessment should be based on the facts as they exist on September 30. See N. & C. Street Railway vs. Wellesley, 207 Mass. 514. 93 N. E. 834. There is no provision in the statute for prorating the tax between different operating companies when there has

> been a change of ownership during the tax year; nor is there any requirement that a company not operating on September 30th shall file a return. The tax is based on gross earnings for a complete year. It disregards operating expense. During the winter months, operating expenses are apt to be much heavier than during the summer. Taxing the gross receipts of the company (or person) which operated during the winter the same as the one operating only during the summer might be unjust to the former."

The reasoning of the Court in the above case applies as well to the instant case where the tax is based on net income as where it is based on gross earnings. The net income of corporations vary materially each month, depend to some extent on the character of the business conducted. Some corporations have little net income during the winter months; others enjoy their greatest return at that season of the year. Some have their greatest prosperity in the summer months, while others do not.

It is plain therefore, that to adopt a straight line method of apportionment irrespective of the net income of the corporation during the months apportioned, would ofttimes be unjust and inequitable and furthermore contrary to the intention of the legislature.

The foregoing question together with that discussed under Point II, of this brief arises in every bankruptcy proceeding in which a corporation is

a bankrupt. In every such instance, bankruptcy is bound to occur during some part of the year for which a franchise tax making it legal to continue to exercise the franchise, is payable. In every such bankruptcy proceeding, a similar claim for apportionment has been and will be made. Such construction resulting in a large depreciation of the amount of taxes which the State received was clearly not within the contemplation of the legislature of the State of New York on its enactment of the statute. It was to avoid such a consequence that the legislature has directly stated that the tax should be paid in advance, and based, not upon business to be done in the future, but on the value of the franchise as determined by the income of the corporation earned during the preceding year. The tax is directly stated to be for the purpose of exercising the corporate franchise within the State of New York, and the continued receipt of the benefits, which the corporate laws of the said State have theretofore conferred upon the corporation.

A statute must be construed with reference to the object to be accomplished by it. In order to attain this object, it is proper to consider the occasion and the necessity of its enactment, the defects or the faults in the former law and the remedy provided by the new law; and the statute should be given that construction, which is best calculated to advance its object by suppressing the mischief and securing the benefits intended, hav-

ing regard to the considerations of public policy and to the established policy of the legislature as indicated by a general course of legislation.

Adopting this well recognized canon of statutory construction, the legislature of the State of New York in the enactment of present Section 209 of the Tax Law of the State of New York plainly intended to eliminate any doubt as to the meaning of language employed in the amendment of that previously contained in tax statutes. This is clearly indicated in the opinion People *ex rel* New York Central & H. R. R. Co. vs. Gaus, an extract of which has heretofore been printed in this brief. Under these circumstances, the referee was clearly right when he stated in his opinion that

> "The tax imposed under either Section 209 or Section 182 as amended is a payment for a privilege whether exercised or not, and is due annually from the corporation until its franchises are withdrawn by the legal dissolution of the corporation, provided always that such tax or payment has been computed or ascertained in the manner required by Section 209 and Section 182 as amended."

POINT II.

The statutory rate of interest provided for by the Tax Law of the State of New York at the rate of one per cent per month should prevail.

The Circuit Court of Appeals for the Second Circuit has further determined that the statutory

rate for delinquency of payment of the tax was a penalty and should be disallowed, and that only 6% interest per annum should be allowed upon the taxes apportioned to the day of the date of actual payment by the Trustee, following a decision it made contemporaneously with the decision of the Ajax Dress Co., involving construction of a Federal statute, conferring similar statutory interest upon tax due the United States Government. *Re:* Menist—In the Menist case, the court refused to follow the decision *in re.* Kallak, 147 Fed. 276; Scheidt 177, Fed. 599; *Re:* Quirnes, 39 A. B. R., 320; and followed in *Re:* Ashland, 229 Fed. 829.

From the opinion, it clearly appears that the question under consideration is one upon the true determination of which various circuits have differed. The decision rendered by the Circuit Court of Appeals for the Second Circuit is contrary to the true principle to be applied for the determination of this question.

In the case of People vs. The Gold & Stock Telegraph Company, 98 N. Y., 67, it was held that it was error, on non-payment of a franchise tax due to the State of New York to allow interest on the tax at six per cent per annum, the Court holding that the statute prescribed the exaction for default in payment and no other additional amount could be collected. The court per Danforth, J., stated, page 79:

> "The State at its pleasure created the charge or tax, and prescribed the penalty for

default of payment. No other can be collected. In this case the Comptroller is directed to add 'ten percentum to the tax of said corporation or company * * * for each and every year for which such tax shall not have been paid' (Sec. 2) and by Section nine an action is given to the People for tax imposed. Interest is not given either by this act or by any general law of the State. The payment of which cannot be imposed by implication. What the State omitted to demand, the Court cannot require. But the legislature has not overlooked in this respect any property right of the State. Where interest is given, it is as damages or compensation for delay in payment. The creditor is supposed to have lost something and to acquire indemnity. Here the legislature has ordained it. Ten per cent annually is to be added. Whether it lay in the mind of the legislature that this was interest or not, we do not know. It is what is given; and that it is given and nothing more, excludes any plausible contention that the taxpayer is liable beyond it."

That no interest other than as prescribed by the Legislature is collectible by the State upon delinquency in the payment of taxes was also determined in City of Rochester vs. Bloss, 185 N. Y. 42. As the court in said decision clearly indicated, (page 52), taxes being mere statutory impositions do not bear interest at common law, nor do statutes providing for interest on debts, contracts and judgments apply to taxes. They do not draw interest as do sums of money owned upon contract but only if it is expressly given. The amount to be paid for the delinquency of a taxpayer to compensate the State for losses sus-

tained through such delinquency must therefore be prescribed by the Legislature.

This statutory charge akin to that interest charge is prescribed in respect to the taxes, allowed in this case by Section 219c of the Tax Law, which prescribes the rate of one per cent per month in addition to ten per cent of the amount of the tax.

In United States vs. Guest, 143 Fed., Rep. 456, the Circuit Court of Appeals for the Fourth Circuit held that the provisions of the United States statutes providing for the collection of delinquent internal revenue taxes with the penalty of five per cent per month, thereon and interest at the rate of five per cent per month, that such interest was not a penalty but was recoverable as interest, there being a five per cent penalty specifically prescribed on the amount of the tax.

In the case of Marshall vs. The People, 254 U. S., 380, The United States Supreme Court affirmed the right of the State to recover in full the amount of taxes due from a corporation in bankruptcy, which embraced within the claim all that the Legislature of the State prescribed should be a part of the tax obligation. This sovereign prerogative to receive in full the moneys required for the public revenue has been at all times recognized in the administration of the Bankruptcy Law of the United States. In fact, Section 64a of the Bankruptcy Act in express words

directs taxes due to a State to be paid in advance of the payment of dividends to creditors without reference as to whether such taxes are liens upon the property of the bankrupt. Bankruptcy cannot therefore operate to divest the State of a right which it could have enforced through its revenue officers by the superior power of distress but for the fact that the property assets of its debtor had passed into custody of a court whose duty it was in the administration and distribution of those assets to respect that paramount right upon the untrammelled exercise of which depends the power to protect the very fund being distributed. (American Bonding Company vs. Reynolds, 203 Fed. Rep., 356; Pennsylvania Steel Co. vs. New York City Railways Co., 193 Fed. Rep. 721; Greeley vs. Provident Savings Bank, 98 Mo., 458).

It is in the application of this principle that the courts in the decisions *in re* Kallak 147 Fed. Rep., 276; *In re* G. L. Schuyler & Company, 21 A. B. R., 428; *In re* Scheidt & Brothers, 23 A. B. R. 778, and *In re* Ramirez-Quinones, 39 A. B. R, 320, determined that the statutory execution for delinquency in payment of a tax due to the State became a part of the tax itself and was recoverable in connection therewith.

In re Kallak, *supra*, Amidon, District Judge, stated page 278:

> "So strongly have these considerations appealed to the courts, that the estates of bankrupts, even while in *custodia legis*, have been

> held subject to taxation by the State and its subordinate agencies."

It was held that if estates may be taxed under such circumstances, no sound reason can be advanced why revenue laws fixing the penalties with full effect in the case of taxes legally levied and assessed prior to the adjudication.

So also *In re* Scheidt & Brothers, *supra*, Sater, District Judge, gives a sound and logical reason for the principle as follows:

> "Its allowance is intended to cover interest until the delinquent taxes are put into judgment (Wheeling & Lake Erie R. R. vs. Wolfe, 13 Ohio Cir. Court Rep., 374), or are paid voluntarily or are collected by special effort by the treasurer in person or by his agent—in some manner other than by process of law. The penalty being treated as interest is collectible as part of the tax itself. (27 Amer. & English Encyc, of Law, 777, 778, 779). Under Section 64 of the Bankruptcy Act, the referee should have directed payment of both the taxes and penalty."

The decision in Ashland, Emory & Corundum, 229 Fed. Rep., 829, which the Circuit Court of Appeals followed, is not alone opposed to the weight of authority but unsound in principle. In allowing the interest at the rate of six percent per annum the Court disregards the well established common law principle that tax obligations bear no interest unless prescribed by the Legislature. In treating the penalty for non-payment of the tax in the same manner as a penalty incurred for the vio-

lation of a criminal statute the Court disregards the well established principle that the Legislature has the right to prescribe an exaction for non-payment of a tax which exaction, unlike the penalty for the commission of a crime, becomes a part of the tax obligation itself similar to ordinary interest on a debt.

The instant case furnishes the additional reason that under the decisions of the Courts of the State of New York, to which reference has been made in this brief, the Courts of the claimant State have determined that the penalty or exaction in question was a legislative imposition of interest, which it was justified to pass as such and which when accrued, became part of the tax obligation and was collectible through the same procedure as the tax itself. The statutory interest, as did the tax, became a lien upon the real and personal property of the debtor. This lien must be recognized by this court to the same extent as the original tax lien. Through the Circuit Court of Appeals, Second Circuit, following the decision quoted, a precedent has been created in this Circuit contrary to principle and authority, and one calling for a final review by this court.

Not alone is the State of New York vitally interested in the proper determination of the question involved, also the National Government in a similar construction of the Federal statute as considered in Matter of Menist, *supra*. In like manner as the first question involved in the instant case, the question of interest is one that will arise

in all bankruptcy proceedings in which the bankrupt is a corporation, and it is as equally necessary to have this question finally and correctly determined.

CONCLUSION.

The decision and determination of the United States Circuit Court of Appeals for the Second Circuit should be reversed and the cause remanded to the said court for the entry of a decree in accordance with the opinion of this court, holding that the claim of the State of New York as filed with the referee in bankruptcy of the Ajax Dress Co. Inc., should be allowed in full without apportionment, and paid in the amount as filed together with interest at the rate of one per cent per month from November 1, 1920, together with the costs and disbursements of this appeal.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM, 1923.

No. 352.

THE PEOPLE OF THE STATE OF NEW YORK,
Appellant,

—against—

LOUIS JERSAWIT, as Trustee in Bankruptcy of AJAX DRESS CO., INC.,
Appellee.

BRIEF FOR APPELLEE.

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BRIEF FOR APPELLEE.

POINT I.

THE FRANCHISE TAX UNDER SECTION 209 OF THE TAX LAW OF THE STATE OF NEW YORK IS NOT A TAX FOR THE PRIVILEGE OF BEING OR CONTINUING TO BE A CORPORATION. IT IS A TAX FOR THE PRIVILEGE OF EXERCISING A FRANCHISE, AND SHOULD THEREFORE BE APPORTIONED WITH RESPECT TO THE LENGTH OF TIME THE PRIVILEGE IS EXERCISED.

Section 209 of the New York Tax Law, so far as material for our purposes, reads as follows:

> "*Franchise Tax on Corporations based on Net Income*: For the privilege of exercising

> its franchise in this state in a corporate or organized capacity, every domestic corporation, and for the privilege of doing business in this state, every foreign corporation * * * shall annually pay in advance for the year beginning November 1st next succeeding the first day of July in each and every year an annual franchise tax to be computed by the tax commission upon the basis of its entire net income for its fiscal or calendar year next preceding, upon which such corporation is required to pay a tax to the United States,".

In the instant case the tax claimed by the State Tax Department of New York is for the year beginning November 1st, 1920, and ending October 31st, 1921, and under the statute computed on the basis of the entire net income of the corporation for the year next preceding November 1st, 1920. The corporation, however, went into bankruptcy on December 22nd, 1920, having exercised its franchise for a little less than two months during the year for which the tax is sought to be imposed.

The controversy, therefore, is whether or not under the statute the corporation was required to pay the tax for the entire year or merely for that portion of the year during which it exercised its franchise. The District Court and the Circuit Court of Appeals have both held that the tax should be apportioned.

In re Ajax Dress Co., Inc., 290 Fed. 950.

Concededly the Section in dispute is silent on the question at issue. The inference, however, that the tax should be apportioned, is not to be denied. The wording of the statute can permit of but one

construction—the construction adopted by the decisions in this state to the effect that *a tax imposed thereunder, being one for the privilege of exercising a franchise and not for the privilege of possessing a franchise must be apportioned with respect to the length of time that the franchise is exercised.*

That view finds support in a leading New York case. *People ex rel Mutual Trust Co. vs. Miller*, 177 N. Y. 51, which though decided under another section of the Tax Law—section 187-a (now 188) of the Tax Law of the State of New York—nevertheless states the general principles applicable to our case. In the *Miller* case the Tax Department of the State of New York sought to exact a franchise tax for an entire year where the Trust Company had only been in existence for six days of the year in question. The company argued that since it had carried on business for only six days during the year for which it was sought to be taxed, the tax should be apportioned with respect to the length of time that it exercised its corporate franchise. This contention was sustained by the Court of Appeals. We quote from the decision of Vann, J., page 54, as follows:

> "The tax under consideration is not imposed upon property, but upon a privilege. *It is not imposed upon the privilege of becoming a corporation, for that would be an organization tax, payable but once for the entire period of corporate existence.* It is imposed 'for the privilege of exercising' the corporate franchise, and is measured by the value of the investment made and used in carrying on the corporate business. *It is an 'annual' tax, imposed 'annually,' as the statute expressly provides, for the privilege of exercising, not of possessing a*

corporate franchise. This privilege was used by the relator for only six days during the fiscal year in question. It could not exercise its franchise for the entire year, because the state did not bring it into existence until the year had nearly expired. *The consideration for the tax is the privilege of carrying on business, yet the relator, according to the requirement of the comptroller, was compelled to pay for a privilege that it did not have and could not exercise during the greater part of the period for which the tax was laid. It used the privilege for only six days, but it is taxed for using it 365 days, during 359 of which it did no business and enjoyed no privilege.* An annual tax is a tax reckoned by the year the same as annual rent or annual interest. An 'annual' tax imposed 'annually,' means a tax that is imposed once a year, computed by the year. If a trust company does not commence business until six days before the fiscal year ends, OR IF IT CEASES TO DO BUSINESS SIX DAYS AFTER THE YEAR BEGINS, THE TAX FOR DOING BUSINESS BY THE YEAR REQUIRES APPORTIONMENT. *While the legislature did not so provide in express terms, it is a fair and reasonable implication from the words used that such was its intention.* When by Section 182 of the Tax Law it imposed an annual tax payable annually upon every corporation of a certain class, to be computed upon the basis of the amount of its capital stock 'employed within the state' during the year, it did not say expressly that the assessment should be determined by the *average* amount of capital so employed, but we held that this was what was necessarily meant. * * *"

The Attorney General argues that the tax under Section 209 is one "for the privilege of continuing to exercise the corporate franchise." This phrase quoted from the Attorney General's Point I is obviously taken from the case of *New Jersey vs. Anderson*, 203 U. S. 483, cited by the Attorney General on page 12 of his brief. On page 490 of the opinion the Court, in discussing the tax there in question, says:

> "We think the weight of judicial decision in that state (New Jersey) favors the view that this is a tax imposed upon the right of the corporation *to continue to be a corporation.*"

Immediately below that on page 490, the Court calls attention to the fact that the tax under discussion is denominated by the New Jersey Statute as a "license tax," that is, a tax for the privilege of being a corporation. That being so, *New Jersey vs. Anderson* (*supra*) is obviously not in point in a discussion of Section 209 of the Tax Law of the State of New York which, to repeat, imposes a tax *for the privilege of exercising a franchise.* The Attorney General is talking of a license tax when he talks of the privilege of continuing. In such a case you pay the tax for a license—a thing that is not divisible. By the express terms, however, of the New York Statute and by the weight of judicial decision in this state, construing that statute, the tax is imposed for the privilege of exercising or using a franchise. *People ex rel Mutual Trust Co. vs. Miller*, 177 N. Y. 51 (*supra*), and *People ex rel L. & N. Y. R. R. Co. vs. Sohmer*, 217 N. Y. 443. Whether under the New Jersey Statute you use what you have bought, makes no difference. But when we pay for the use of the thing, as you do

under Section 209 (*supra*), how can we be consistent and say "true, the tax is imposed for the use of a thing, but whether or not you use it makes no difference. You must pay the tax in any event."

Such a view is favored neither in logic nor in Justice.

THE CHANGES IN THE WORDING OF THE STATUTE UNDER DISCUSSION HAVE WORKED SOME CHANGES IN EFFECT WITHOUT HOWEVER NECESSITATING A CHANGE IN THE RESULT OF THE INSTANT CASE.

The general principles applicable to our question remain unchanged. It is argued that Section 182 of the Tax law of the State of New York has been changed to the extent of nullifying entirely the effect of the case of *People ex rel Mutual Trust Co. vs. Miller*, 177 N. Y. 51. It is further argued that the case of *People ex rel N. Y. C. & H. R. R. R. Co. vs. Gaus*, 200 N. Y. 328, decided under the amended Section 182 has expressly overruled *People ex rel Mutual Trust Co. vs. Miller* (*supra*). Both of these arguments state only half truths.

The *Miller* case is decided under Section 187-a (now Section 188) of the Tax Law. That section reads:

> "Every Trust Company * * * shall pay to the state annually for the privilege of *exercising its corporate franchise* an annual tax which shall be equal to 1% on the amount of its capital stock, surplus and undivided profits."

Under this section the tax apparently is paid at the end of the year and is computed on the basis of the capital stock, surplus and undivided profits

used by the Trust Company during that year. That is to say, the tax is in payment of a privilege already exercised and is computed on the basis of the amount of capital employed during the period when the privilege was so exercised. We emphasize these facts. As will be seen later, they are essential in arriving at the real significance of the changes made in the Tax Law.

The *Gaus* case is decided under Section 182 of the Tax Law, which reads:

> "For the privilege of *exercising its corporate franchise* in this state every domestic corporation * * * shall pay to the State Treasurer annually in advance an annual tax to be computed upon the basis of the amount of its capital stock employed during the preceding year within this state and upon each dollar of su amount."

Under this section the tax is paid for a privilege to be exercised during the year succeeding the date the tax is payable, but is computed on the basis of capital stock employed during the preceding year. That is the important distinction between the two sections and the two cases decided under each of these sections respectively. Indeed this very difference is suggested in the *Gaus* case (see pages 330, 331 of the opinion) where the Court says:

> "After our decision (referring to the *Miller* case), however, the Legislature amended Section 182 of the Tax Law so as to provide that the tax should be paid in advance. The amendment changed the character of the tax as to corporations embraced within that Section *from a payment for past privileges already en-*

joyed to a payment for privileges to be enjoyed during the following year."

The Attorney General emphasizes this quotation on page 15 of his brief by means of italics. He emphasizes and is impressed mainly with the fact that the law has somehow been changed. The significance of the change, however, has escaped him. He has accepted the *Gaus* decision as a blanket reversal of everything in the *Miller* decision. That, however, is clearly not the case.

It is important to note that in the *Miller* case the privilege for which the tax was levied was exercised during the very year taken as a basis for the computation of the tax. Because of that, but one method of apportionment appears possible. An analysis, however, of our problem shows that we are permitted to make a double apportionment: (1) an apportionment with respect to the computation of the tax or the value of the franchise, and (2) an apportionment with respect to the length of time the franchise is exercised. For example, take a state of facts parallel with those in the *Miller* case. Let us assume that a corporation employs a capital stock of $50,000 for the first three months of a year and then increases its capital stock to $100,000 during the second quarter of the year, so that for the second quarter of the year it employs a capital stock of $100,000. Let us assume further that this corporation goes out of business at the end of the half year. Problem: what is the tax to be imposed for the exercise of its franchise during that half year? Which of our two methods shall we apply in computing the tax to be paid by this corporation? The *Miller* case would seem to indicate that the tax to be paid by the corporation is to be computed on the basis of the average amount of capital stock used

during the time the corporation exercised its franchise; that is, the apportionment of the tax takes place at the moment the tax is computed and in a single process. That does not seem to us to be the logical method. Rather it would seem that the tax should be computed on the basis of the entire amount of capital stock used during the entire year without averaging. Then once the tax is so computed for the entire year the apportionment should take place. If the corporation has used its franchise for but half a year, the tax should be half of the figure so computed. That method seems to have been intended by the Legislature. The only apportionment logically permitted under the statute is an apportionment with respect to the length of time the franchise was used, and that is the only apportionment we should make. In fact, we believe that it is because of the misconception on the part of the Courts in construing the tax statutes that the Legislature amended the tax sections under discussion herein so as to indicate clearly that in computing a tax, *in arriving at the value of the use of a franchise*, we should not average or apportion with respect to the length of time the capital stock, the basis of the computation, was employed. Apportionment should take place thereafter. Once having arrived at the figure to be paid for the privilege of using a franchise for the year, it is then a simple matter to compute how much of that figure is to be paid, depending upon how long the franchise is used.

That distinction is not apparent in the *Miller* case, for the very obvious reason that whether we employ the one method of determining the tax or the other, the result arrived at is the same; the reason for that being that the amount of capital stock remained unchanged, and the length of time

during which the capital stock was employed and the length of time during which the franchise was used were identical.

When, however, we come to consider the amendments made in Section 182 of the Tax Statute, and the *Gaus* case decided thereunder, the distinction between the two methods of apportionment becomes quite clear. Due to the confusion existing theretofore, the Legislature by its amendment in making the tax payable in advance indicated that the only method of apportionment was to be the second one, to wit, an apportionment with respect to the length of time the franchise was used—the only logical apportionment under the statute before and after the amendment. And that is what the *Gaus* case decided (and we submit that is the only thing argued and decided in the *Gaus* case), viz., that in computing the tax we are not permitted to average or apportion. At that point we must take as the basis of our computation the entire amount of capital stock used during the preceding year, whether used for one day or for the entire year. The other question, whether or not the tax was to be apportioned with respect to the length of time the privilege was used, was not at issue, was not argued nor even considered in the *Gaus* case. The conclusion in the *Gaus* case is obviously correct and undoubtedly interprets the changes in the statute and gives effect to the Legislative intention in making such changes.

We quarrel with but one phrase in the *Gaus* case used, we believe, inadvertently by the Court. The Court says on pages 330 and 331 of the opinion: "The amendment changed the character of the tax." That is not true. Under the previous statute the tax was imposed "for the privilege of exercising a franchise" and under the amended

statute the tax is imposed for exactly the same privilege. The character of the tax was not changed. It was only the method of computation, the method of arriving at the value of the annual tax that was changed. The nature of the tax remained the same. And so far as the character of the tax is concerned, the words of the *Miller* case are as applicable today as they were when that case was decided. It is a tax "not imposed upon property but upon a privilege. *It is not imposed upon the privilege of becoming a corporation, for that would be an organization tax payable but once for the entire period of corporate existence. It is imposed for the privilege of exercising a corporate franchise.* * * * *It is an 'annual' tax imposed 'annually' as the statute expressly provides for the privilege of exercising not of possessing a corporate franchise*" (page 54 of the opinion). And the conclusion is that if the privilege is exercised but for a portion of the year, the corporation should be required to pay for only that portion of the year during which it makes use of the privilege.

As was said above, the amended statute, like the previous statute, is silent on the precise point at issue. The Attorney General's contention that the changes in the statute necessitate an entire change in result, is too simple to be true. It leaves too many things unexplained. Had the Legislature sought to make a change in the nature of the tax what was there to prevent it from changing the words "for the privilege of exercising its corporate franchise."

The phrase "for the privilege of exercising a franchise" had under the *Miller* case (*supra*) and under the *Sohmer* case (*supra*) assumed a very definite meaning, one contrary to that urged by the Attorney General. Can it, in the face of that, be

argued that in using the identical words the Legislature intended a change in the character of the tax? Furthermore, what was there to prevent the Legislature from saying in so many words that the tax should in no wise be apportioned. The answer is compelling. The Legislature did not intend to exact a tax for the privilege of exercising a franchise whether or not the franchise was exercised. Its intention in making the change was the one indicated above, that in computing the tax, in arriving at the annual charge to be made, there was to be no averaging or apportioning. It did away with whatever confusion had crept into the decisions in computing the tax. That change and that change alone is the one the Legislature made.

Appellee further urges upon the Court this well established principle, that where in a tax statute the Legislature leaves some doubt for the Court to resolve, that immediately creates a presumption in favor of the citizen and against the state. Statutes are always thuswise strictly construed.

> *People ex rel Mutual Trust Co. vs. Miller* (*supra*).

As was said in that case:

> "A statute which levies a tax is to be construed most strongly against the government and in favor of the citizen. The government takes nothing but what is given by the clear import of the words used and a well founded doubt as to the meaning of the Act defeats the tax."

The Attorney General calls attention to one other change in the statute which to him seems to change

the nature of the tax. Whereas previously the law read:

> "for the privilege of doing business or exercising its corporate franchise"

it now reads:

> "for the privilege of exercising its corporate franchise."

The words "for the privilege of doing business" are omitted. From this change the Attorney General can derive but one conclusion, namely, that the Legislature intended to change the nature of the tax. That however is not a necessary consequence. In fact the explanation is much simpler. The intention manifestly was merely to get rid of superfluous words. The terms "doing business" and "exercising a franchise" are synonymous and have so been construed.

> *People ex rel L. & N. Y. R. R. Co. vs. Sohmer*, 217 N. Y. 443;
> *People ex rel Mutual Trust Co. vs. Miller*, 177 N. Y. 51.

We have twice before quoted words from the *Miller* case which define the meaning of the phrase "for the privilege of exercising a franchise," to show that exercising a franchise does not mean merely being a corporation. The *Sohmer* case establishes beyond question that the phrases "doing business" and "exercising a franchise" are identical in meaning. That case was decided under the statute before its amendment whereby the words "of doing business or" were omitted. It must be noted that the previous statute read in the alternative "for the privilege of doing business or exercising its

franchise." The *Sohmer* decision held that even though the defendant continued to be a corporation in this state it was not taxable because it was not doing business in this state. If the Attorney General is correct in his contention that exercising a franchise means merely being a corporation, then what difference did it make in the *Sohmer* case whether or not the defendant was doing business in this state, since the tax there imposed on the corporation was either for the privilege of doing business or exercising its franchise. And if exercising its franchise means merely "continuing to be a corporation" then clearly the defendant should have paid the tax imposed by the statute. Since it was conceded that the corporation had continued in existence. Nor can the Attorney General argue that this point was not called to the attention of the Court. It was very emphatically called to the Court's attention as is evidenced by the dissenting opinion that takes the view urged by the Attorney General. The question was squarely before the Court and by a majority of five to two it decided "doing business" and "exercising a franchise" were synonymous terms. That being so, it follows that the Legislature with the *Miller* case and the *Sohmer* case before it adopted their construction of the phrase and omitted the words "doing business" from the amended statute as superfluous.

Another word and we are finished with this phase of the case. The Attorney General also calls attention to the fact that the statute reads differently with respect to domestic corporations and foreign corporations. The statute says "For the privilege of exercising its franchise in this state every domestic corporation, and for the privilege of doing business in this state every foreign

corporation," etc. Hence, it is argued, the terms "exercising its franchise" and "doing business" must necessarily have different meanings. The answer to that is that a foreign corporation has no franchise to exercise in this state; that the only place where it can exercise its franchise is the state where it has been granted. The only thing that a foreign corporation can do in our state is obtain the privilege of doing business here. The Legislature has indicated this difference with a fine discrimination of language.

Applying these principles and reading the statute in the light of the decisions of the highest courts in the State of New York interpreting similar language in tax statutes, the conclusion follows that the apportionment of the tax was right and fully warranted. It is not for the Court to say that the price of exercising a corporate franchise shall be the same for one day as for one year. The matter can be readily remedied by the Legislature, if such be its intention, by amending the statute so as to provide expressly against an apportionment of the tax.

POINT II.

THE COURT BELOW PROPERLY HELD THAT A CLAIM FOR INTEREST AT THE RATE OF ONE PER CENT. PER MONTH IN A BANKRUPTCY PROCEEDING IS A PENALTY AND SHOULD BE DISALLOWED.

Section 57-j of the Bankruptcy Act provides as follows:

> "Debts owing to the United States, a state, a county, a district, or a municipality as a

> penalty or forfeiture, shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transfer or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

The District Judge and the Circuit Court of Appeals held that interest on the tax should be allowed up to the date of payment, but that interest at the rate of one per cent (1%) per month amounts to a penalty and must be disallowed, under Section 57-j of the Bankruptcy Act.

There has been some conflict of authority on this question, but we submit that the reasoning in *re Ashland, Emery & Corundum Co.*, 229 Fed. 829, which was followed by both the District Judge and the Circuit Court of Appeals, is sound in principle and a proper interpretation of the Bankruptcy Act.

In that case the Court said at page 831:

> "If the charge here in controversy is to be regarded as interest, the trustee ought to pay it. Penalties, however, stand upon a different footing. It cannot be said that a penalty imposed for failure to pay a tax, is part of the original tax, in the sense that interest is. By 'interest' is ordinarily understood a charge for the use of money or damages for the detention of it. A penalty, as applied to cases of this character, means a punishment imposed for failure to make the payment on time. Section 64-a contains no provision for the payment of penalties; and I do not think

> it can fairly be construed to include them, especially when, as here, the estate was in course of administration during the entire period when they accrued."

and again at page 832:

> "Assuming, however, that it is, it seems to me plain, and I accordingly find, that 1% a month exceeds what is fairly required to make good loss to the state for mere delay in the payment of the tax, and as to such excess is not interest, but constitutes a penalty imposed for failure to pay promptly. The actual damages sustained by the State of New Jersey from the delay are not obscure nor difficult to estimate. What the state lost was the use of the money. Its damages therefore are the commonest form known to the law, and the most certain of estimation. They are established by statute in New Jersey for individuals at 6% per annum."

The fact that the statute itself calls it interest would not be conclusive upon the Bankruptcy Court, which has the right and power as well as the duty, to examine and decide the question for itself.

> *In re Ashland, Emery & Corundum Co.* (*supra*);
> *State of New Jersey vs. Anderson*, 203 U. S. 483.

In disposing of this branch of the case, the Circuit Court of Appeals did not express its views, but referred to its decision filed the same day in *re J. Menist & Co. Inc.*, 290 Fed. 947. Judge Hough

who wrote the poinion, refers to most of the cases cited by the appellant. In two of the cases, in *re Kallak*, 147 Fed. 276, and in *re Quinones*, 39 Am. Br. 320, the point that the additional interest constituted a penalty and was, therefore, not provable in a bankrptcy proceeding by reason of the provisions of Section 57-j of the Bankruptcy Act, does not seem to have been argued. The point also seems not to have been argued in *re Scheidt*, 177 Fed. 599, except that the Court makes the statement that the penalty being treated as interest, is collectible as a part of the tax itself under the Ohio law. The Circuit Court of Appeals, however, declined to concur in the implications of these cases.

As pointed out by Judge Hough in *re Menist*, *supra*, the case of *U. S. vs. Guest*, 143 Fed. 456, relied upon at page 27 of appellant's brief, has no application because the question there did not arise in a bankruptcy proceeding. The same may be said of the case of *Marshall vs. The People*, 254 U. S. 380, cited by appellant. The question involved in that case was one of priority. As stated by Mr. Justice Brandeis, who wrote the opinion in that case:

> "The single question is presented whether the State of New York has priority in payment out of the general assets of the debtor over other creditors whose claims are not secured by act of the parties nor accorded a preference, by reason of their nature, by the state of legislature or otherwise."

Surely, it is submitted, it is far afield to contend that this decision supports the claim of the appellant with respect to the penalty and interest.

In considering the disallowance of interest at the rate of 1%, it should be borne in mind that we are concerned only with the Bankruptcy Statute.

The conclusion, therefore, it is submitted, is inescapable that in the absence of proof of pecuniary loss by a state or municipality, interest at the rate of 1% is a penalty within the language of Section 57-j of the Bankruptcy Act, and is not an allowable claim.

POINT III.

THE DECISION AND DETERMINATION OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, SHOULD BE AFFIRMED WITH COSTS.

Respectfully submitted,

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HENRY B. SINGER,
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ABRAHAM H. RUBENSTEIN,
of the City of New York,
with him on the brief.

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Decree affirmed.

PEOPLE OF THE STATE OF NEW YORK *v.* JERSAWIT, TRUSTEE IN BANKRUPTCY OF AJAX DRESS COMPANY, INC.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 352. Submitted December 3, 1923.—Decided January 7, 1924.

1. The tax laid on a domestic corporation in New York, (Tax Law, § 209,) for the privilege of exercising its franchise in the State, to

be paid annually "in advance" for the year beginning November 1st, to be computed upon the basis of the entire net income of the corporation for its fiscal, or the calendar, year preceding, is an entirety and cannot be apportioned to a fraction of the tax year which has elapsed when the corporation goes out of business. P. 495.

2. The State has a claim for the entire tax when the corporation is thrown into bankruptcy after lapse of part of the tax year. *Id.*

3. The addition of 10%, where the tax is not paid by January 1st, is a penalty, and the further addition of 1% for each month the tax remains unpaid, is not statutory interest, but part of the penalty; and neither can be allowed the State in a bankruptcy proceeding. Bankruptcy Act, § 57j. P. 496.

290 Fed. 950, reversed.

CERTIORARI to an order of the Circuit Court of Appeals which affirmed an order of the District Court, in bankruptcy, adjudicating a claim made by the State of New York for a tax.

Mr. Robert P. Beyer and *Mr. C. T. Dawes*, Deputy Attorneys General of the State of New York, for petitioner. *Mr. Carl Sherman*, Attorney General, was also on the briefs.

Mr. Henry B. Singer for respondent. *Mr. Abraham H. Rubenstein* was also on the brief.

MR. JUSTICE HOLMES delivered the opinion of the Court.

This case comes here upon certiorari, 262 U. S. 741, to review a decision apportioning a claim in bankruptcy for taxes, presented by the State of New York. 290 Fed. 950. On December 22, 1920, a petition was filed against the Ajax Dress Company, a manufacturing or mercantile corporation of the State of New York, and it was adjudicated a bankrupt. The State filed a claim for a tax for the year between November 1, 1920, and October 31, 1921, and for "penal interest", under §§ 209

and 219-c of the Tax Law of New York. Section 209 provides that "For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation . . . shall annually pay in advance for the year beginning November first . . . an annual franchise tax, to be computed by the tax commission upon the basis of its entire net income for its fiscal or the calendar year next preceding." The Company ceased business on the day when the petition was filed and the Courts below held that the tax was to be apportioned to the time, somewhat less than two months, that the franchise was exercised. By § 219-c of the same tax law the tax is to be paid on or before January 1 of each year and if it is not paid the corporation liable shall pay "in addition to the amount of such tax, . . . ten per centum of such amount, plus one per centum for each month the tax . . . remains unpaid." The Courts below held that this latter liability was a penalty and therefore not to be allowed, but allowed six per cent. upon the tax as apportioned, to the date of payment. The State says that it is entitled to the statutory interest or none.

On the main question the Circuit Court of Appeals rightly recognized that the construction of the state law by the State Courts should control, but found nothing nearer than *People ex rel. Mutual Trust Co.* v. *Miller*, 177 N. Y. 51, where a different statute was held to tax the privilege of carrying on the business as actually exercised and therefore to create an apportionable liability. If the State Court should decide that the present act was to be construed in the same way we should bow, but until it does so we must regard the meaning as tolerably plain. The amount to be paid is not determined by the business done during the period taxed but by the net income of the year before. It is made a legal duty, by what the Courts below rightly held to be

a penalty, to pay the tax in advance. When the law discussed in the *Mutual Trust Company's Case, supra,* was amended so as to provide that the tax should be payable in advance, the Court of Appeals said that the amendment changed the character of the tax and that the grounds of the former decision were no longer applicable. *People ex rel. New York Central & Hudson River R. R. Co.* v. *Gaus,* 200 N. Y. 328. It hardly can be supposed that if the tax had been paid the State would recognize a claim for a proportionate return. We are of opinion that the tax is a tax upon the right conferred, not upon the actual exercise of it, that it was due when the petition in bankruptcy was filed, *New Jersey* v. *Anderson,* 203 U. S. 483, 494, and that the claim of the State for the whole sum should have been allowed.

There can be no doubt that the additional ten per centum charged for failure to pay by January 1 is a penalty, disallowed by the Bankruptcy Act, § 57j, but it is urged that the one per centum for each month of default is statutory interest and that the State is entitled to that and otherwise would be entitled to none. As the one per centum is more than the value of the use of the money and is added by the statute to the ten to make a single sum it must be treated as part of one corpus and must fall with that. We presume that in this event the State does not object to receiving the simple interest allowed. That part of the order will stand.

Order reversed.